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Insider Trading in Capital Market: A Legal Perspective

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ABSTRACT

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is popularly used in the negative sense as it is perceived that the persons having access to the price sensitive and unpublished information used the same for their personal gains. However insider trading per se does not mean any illegal conduct. It encompasses both legal as well as illegal conduct. The legal version is when corporate insider's officers, directors, and employees buy and sell stock in their own companies. In order to legalize their transactions, the directors and employees of the company should inform about their dealing with the securities to the SEBI. However, commonly often we associate this term with the breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, non public information about the security. Insider trading is defined by the Black's Law Dictionary in the following words - "The use of material non public information in trading the shares of the company by a corporate insider or any other person who owes a fiduciary duty to the company

A study by the international consultants Ernst & Young (E&Y) is reported to have noted that India has a low rate of fraud perpetrated by company insiders. Around 84 percent of the fraud involves the hand in glove relationship between the employees and a third party.

KEYWORDS: *SEBI, IPO, FPO, Sachar Committee and Patel Committee, Insider Trading as a Crime, Insiders in India and Abroad*

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Therefore, the surveillance mechanism in countries United States is quite tough to even rule out such a probability. However, lower rates of employee fraud do not mean that Indian company managements are honest and that shareholders get a better deal in India than elsewhere. Ernst and Young also came out with an interesting observation that in India company insiders with privileged access to information indulge in rampant insider trading for personal gains rather than to benefit the shareholders. Therefore, the obvious conclusion drawn by Economic Times//was that the controlling interests and not the employees who take the shareholders for a ride SEBI is the watchdog of all the stock exchanges in India. It has been obligated to protect the interest of the investors in the securities market and to regulate the stock market through such other regulations as it deems fit. The SEBI acts as the regulator in the share market by taking all precautionary measures in order to repose the confidence of the investors who are investing in the market. The author has conducted an extensive research on the disclosure and divulging of the price sensitive information which would affect the share prices and disturb the equations in the share market. It is due to the very fact that the investors invest on the shares being speculative, but when the prices of the shares could be predicted well before in hand then they may take a decision accordingly. Hence, pre determined price may result in undesired consequences as people may buy huge amount of shares whose value may appreciate.

The SEBI has dealt with a wide ranging plethora of cases on insider trading concerning the following aspects. The secret agreement often involves individuals who have a relationship. It may be family relationship or a business relationship. Some of them are mentioned below.

- ➢ Corporate officers, directors, and employees who traded the corporations securities after learning of significant, confidential corporate developments;
- ➢ Friends, business associates, family members, and other types of such officers, directors, and employees, who traded the securities after receiving such information;
- ➢ Employees of law, banking, brokerage and printing firms who were given such information

to provide services to the corporation whose securities they traded;
- Government employees who learned of such information because of their employment by the government; and
- Other persons who misappropriated, and took advantage of confidential information from their employers.

Because insider trading undermines investor confidence in the fairness and integrity of the securities markets, the SEBI has treated the detection and prosecution of insider trading violation as one of its enforcement priorities.

INTRODUCTION

Conceptualization of Capital Markets

Capital markets are like any other markets, but differ in terms of the products traded and their organization. Capital markets deal with the trading of securities. Capital markets provide avenue where companies can raise funds to expand on their businesses or establish new ones by issuing securities owned by the companies. Like businesses in the private sector, Government issue its securities to raise funds in capital markets to build electricity damn, construct new roads, bridges by issues.

Significance of Capital Markets

A well functioning stock market may help the development process in an economy through the following channels:

1. Growth of savings,
2. Efficient allocation of investment resources,
3. Better utilization of the existing resources.

In market economy like India, financial market institutions provide the avenue by which long-term savings are mobilized and channelled into investments. Confidence of the investors in the market is imperative for the growth and development of the market. For any stock market, the market Indices is the barometer of its performance and reflects the prevailing sentiments of the entire economy. Stock index is created to provide investors with the information regarding the average share price in the stock market. The ups and downs in the index represent the movement of the equity market. These indices need to represent the return obtained by typical portfolios in the country.

Generally, the stock price of any company is vulnerable to three types of news:

- Company specific
- Industry specific
- Economy specific

An all share index includes stocks from all the sectors of the economy and thus cancels out the stock and sector specific news and events that affect stock prices, (law of portfolio diversification) and reflect the overall performance of the company/equity market and the news affecting it.

Conceptualization of Securities

Securities are financial instruments or legal documents signifying either an ownership position in a company (i.e. shares) or a creditor relationship with a company or government (i.e. Stocks and bonds).

Capital Market Instruments – some of the capital market instruments are:

- Equity
- Preference shares
- Debenture/ Bonds
- ADRs/ GDRs
- Derivatives

Corporate securities

Shares

The total capital of a company may be divided into small units called shares. For example, if the required capital of a company is US $5, 00,000 and is divided into 50,000 units of US $10 each, each unit is called a share of face value US $10. A share may be of any face value depending upon the capital required and the number of shares into which it is divided. The holders of the shares are called share holders. The shares can be purchased or sold only in integral multiples.

Equity shares signify ownership in a corporation and represent claim over the financial assets and earnings of the corporation. Shareholders enjoy voting rights and the right to receive dividends; however in case of liquidation they will receive residuals, after all the creditors of the company are settled in full. A company may invite investors to subscribe for the shares by the way of:

- Public issue through prospectus
- Tender/ book building process
- Offer for sale
- Placement method
- Rights issue

Stocks

The word stock refers to the old English law tradition where a share in the capital of the company was not divided into "shares" of fixed denomination but was issued as one chunk. This concept is no more prevalent, but the word "stock" continues. The word "joint stock companies" also refers to this tradition.

Debt Instruments

A contractual arrangement in which the issuer agrees to pay interest and repay the borrowed amount after a specified period of time is a debt instrument.

Certain features common to all debt instruments are:

- **Maturity** – the number of years over which the issuer agrees to meet the contractual obligations is the term to maturity. Debt instruments are classified on the basis of the time remaining to maturity
- **Par value** – the face value or principal value of the debt instrument is called the par value.
- **Coupon rate** – agreed rate of interest that is paid periodically to the investor and is calculated as a percentage of the face value. Some of the debt instruments may not have an explicit coupon rate, for instance zero coupon bonds. These bonds are issued on discount and redeemed at par. Thus the difference between the investor's investment and return is the interest earned. Coupon rates may be fixed for the term or may be variable.
- **Call option** – option available to the issuer, specified in the trust indenture, to 'call in' the bonds and repay them at pre determined price before maturity. Call feature acts like a ceiling for payments. The issuer may call the bonds before the stated maturity as it may recognize that the interest rates may fall below the coupon rate and redeeming the bonds and replacing them with securities of lower coupon rates will be economically beneficial. It is the same as the prepayment option, where the borrower prepays before scheduled payments or slated maturity
- **Refunding provisions** – in case where the issuer may not have cash to redeem the debt instruments the issuer may issue new debt instrument and use the proceeds to repay the securities or to exercise the call option. Debt instruments may be of various kinds depending on the repayment:
- **Bullet payment** – instruments where the issuer agrees to repay the entire amount at the maturity date, i.e. lump sum payment is called bullet payment
- **Sinking fund payment** – instruments where the issuer agrees to retire a specified portion of the debt each year is called sinking fund requirement
- **Amortization** – instruments where there are scheduled principal repayments before maturity date are called amortizing instruments

Debentures/ Bonds

The term Debenture is derived from the Latin word 'debere' which means 'to owe a debt'. A debenture is an acknowledgment of debt, taken either from the public or a particular source. A debenture may be viewed as a loan, represented as marketable security. The word "bond" may be used interchangeably with debentures.

Debt instruments with maturity more than 5 years are called 'bonds'

Main differences between shares and debentures

- Share money forms a part of the capital of the company. The share holders are part proprietors of the company, whereas debentures are mere debt, and debenture holders are just creditors.
- Share holders get dividend only out of profits and in case of insufficient or no profits they get nothing and debenture holders being creditors get guaranteed interest, as agreed, whether the company makes profit or not.
- Share holders are paid after the debenture holders are paid their due first
- The dividend on shares depends upon the profit of the company but the interest on debentures is very well fixed at the time of issue itself.
- Shares are not to be paid back by the company whereas debentures have to be paid back at the end of a fixed period.
- In case the company is wound up, the share holders may lose a part or full of their capital but he debenture holders invariably get back their investment.
- Investment in shares is riskier, as it represents residual interest in the company. Debenture, being debt, is senior.
- Debentures are quite often secured, that is, a security interest is created on some assets to back up debentures. There is no question of any security in case of shares.
- Share holders have a right to attend and vote at the meetings of the share holders whereas debenture holders have no such rights.

Quasi debt instruments

Preference shares

Preference shares are different from ordinary equity shares. Preference share holders have the following preferential rights

1. The right to get a fixed rate of dividend before the payment of dividend to the equity holders.
2. The right to get back their capital before the equity holders in case of winding up of the company.

Stock Exchange

The Stock Exchange is one of the institutions in the Capital markets. It is an organized market in securities (shares, stocks and bonds). On this market, individuals and companies can buy shares of companies through Licensed Dealing Member (Stockbrokers) of the Stock Exchange and hence become part- owners or shareholders of these companies. Similarly, individuals or companies through Stockbrokers can buy stocks and bonds of other companies and the Government, and become lenders to or creditors of these companies or the Government.

Any individual or company who at one time or the other lent money or bought shares through the Stock Exchange can also sell back the relevant shares or stocks through the stock Exchange at any time.

The Stock Exchange has its rules and regulations which govern it. These rules and regulations are designed to protect all market participants, including the individual who puts up some funds to invest.

- **Conceptualization of Financial markets**

Financial market is a market where financial instruments are exchanged or traded and helps in determining the prices of the assets that are traded in and is also called the price discovery process.

1. Organizations that facilitate the trade in financial products. For e.g. Stock exchanges (NYSE, NASDAQ) facilitate the trade in stocks, bonds and warrants.
2. Coming together of buyer and sellers at a common platform to trade financial products is termed as financial markets, i.e. stocks and shares are traded between buyers and sellers in a number of ways including: the use of stock exchanges; directly between buyers and sellers etc.

Financial markets may be classified on the basis of
- Types of claims – debt and equity markets
- Maturity – money market and capital market
- Trade – spot market and delivery market
- Deals in financial claims – primary market and secondary market

Indian Financial Market consists of the following markets:
- Capital Market/ Securities Market
- Primary capital market
- Secondary capital market
- Money Market
- Debt Market

Primary capital market- A market where new securities are bought and sold for the first time

Types of issues in Primary market
- Initial public offer (IPO) (in case of an unlisted company),
- Follow-on public offer (FPO),
- Rights offer such that securities are offered to existing shareholders,
- Preferential issue/ bonus issue/ QIB placement
- Composite issue, that is, mixture of a rights and public offer, or offer for sale
  (Offer of securities by existing shareholders to the public for subscription).

Difference between Primary market Secondary markets

Deals with new securities Market for existing securities, which are already listed Provides additional capital to issuer companies No additional capital generated. Provides liquidity to existing stock leading stock exchanges:
- Bombay Stock Exchange Limited
- Oldest in Asia
- Presence in 417 cities and towns in India
- Trading in equity, debt instrument and derivatives
- National Stock Exchange
- New York Stock Exchange NYSE)
- NASDAQ
- London Stock Exchange

Functions of Stock Exchanges
- Liquidity and marketability of securities
- Fair price determination
- Source of long-term funds
- Helps in capital formation
- Reflects general state of economy

Basics of Stock Market Indices:

A stock market index is the reflection of the market as a whole. It is a representative of the entire stock market. Movements in the index represent the average returns obtained by the investors. Stock market index is sensitive to the news of:
- Company specific
- Country specific

Thus the movement in the stock index is also the reflection of the expectation of the future performance of the companies listed on the exchange

Settlement cycles:

Settlement is the process whereby the trader who has made purchases of scrip makes payment and the seller selling the scrip delivers the securities. This settlement process is carried out by Clearing Houses for the stock exchanges. The Clearing House acts like an intermediary in every transaction and acts as a seller to all buyers and buyer to all sellers.

Capital market and money market:

Financial markets can broadly be divided into money and capital market.

Money Market: Money market is a market for debt securities that pay off in the short term usually less than one year, for example the market for 90-days treasury bills. This market encompasses the trading and issuance of short term non equity debt instruments including treasury bills, commercial papers, bankers acceptance, certificates of deposits, etc.

Capital Market: Capital market is a market for long-term debt and equity shares. In this market, the capital funds comprising of both equity and debt are issued and traded. This also includes private placement sources of debt and equity as well as organized markets like stock exchanges. Capital market includes financial instruments with more than one year maturity.

➢ **Conceptualization of Insider trading**

Insider trading is the trading of a corporation's stock or other securities (e.g. bonds or stock options) by individuals with potential access to non-public information about the company. In most countries, trading by corporate insiders such as officers, key employees, directors, and large shareholders may be legal, if this trading is done in a way that does not take advantage of non-public information. However, the term is frequently used to refer to a practice in which an insider or a related party trades based on material non-public information obtained during the performance of the insider's duties at the corporation, or otherwise in breach of a fiduciary or other relationship of trust and confidence or where the non-public information was misappropriated from the company.[2]

In other words Insider trading means dealing in Securities of a company by its Directors, Employees or other Insiders based on unpublished Price Sensitive Information. Such dealings by Insiders erode the investors' confidence in the integrity of the management and are unhealthy for the capital markets. The Securities and Exchange Board of India (SEBI), in its endeavour to protect the interests of investors in general, had formulated the SEBI (Insider Trading) Regulations, 1992 under the powers conferred on it under the SEBI Act, 1992. These regulations came into force with effect from 19th November 1992 and the same were made applicable to all companies whose shares were listed on Indian stock exchanges.

In the United States and several other jurisdictions, trading conducted by corporate officers, key employees, directors, or significant shareholders (in the U.S., defined as beneficial owners of ten percent or more of the firm's equity securities) must be reported to the regulator or publicly disclosed, usually within a few business days of the trade. Many investors follow the summaries of these insider trades in the hope that mimicking these trades will be profitable. While "legal" insider trading cannot be based on **material non-public information**, some investors believe corporate insiders nonetheless may have better insights into the health of a corporation (broadly speaking) and that their trades otherwise convey important information (e.g., about the pending retirement of an important officer selling shares, greater commitment to the corporation by officers purchasing shares, etc.)

Illegal insider trading is believed to raise the cost of capital for securities issuers, thus decreasing overall economic growth.[3]

However, it is relatively easy for insiders to capture insider-trading like gains through the use of transactions known as "open market repurchases." Such transactions are legal and generally encouraged by regulators through safe harbors against insider trading liability.[4]

Definition and Meaning of "insider"

"**Insider**" 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.

In the United States and Germany, for mandatory reporting purposes, corporate insiders are defined as a company's officers, directors and any beneficial owners of more than ten percent of a class of the company's equity securities. Trades made by these types of insiders in the company's own stock, based on material non-public information, are considered to be fraudulent since the insiders are violating the fiduciary duty that they owe to the shareholders. The corporate insider, simply by accepting employment, has undertaken a legal obligation to the shareholders to put the shareholders' interests before their own, in matters related to the corporation. When the insider

[2]Insider Trading U.S. Securities and Exchange Commission, accessed Aug 7, 2012

2. "The World Price of Insider Trading" by Utpal Bhattacharya and Hazem Daouk in the Journal of Finance, Vol. LVII, No. 1 (July. 2012)

[4] Amedeo De Cesari, Susanne Espenlaub, Arif Khurshed and Michael Simkovic, "The Effects of Ownership and Stock Liquidity on the Timing of Repurchase Transactions", 2010

buys or sells based upon company owned information, he is violating his obligation to the shareholders.

For example, illegal insider trading would occur if the chief executive officer of Company A learned (prior to a public announcement) that Company A will be taken over, and bought shares in Company A knowing that the share price would likely rise.

According to the Regulations "**insider"** 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, connection, to unpublished price sensitive information in respect of securities of a company, or who has received or has had access to such unpublished price sensitive information;

The above definition in turn introduces a new term "**connected person**". The Regulation defines that a "connected person" means any person who-

1. Is a director, as defined in clause (13) of section 2 of the Companies Act, 1956 (1 of 1956) of a company, or is deemed to be a director of that company by virtue of sub-clause (10) of section 307 of that Act or
2. occupies 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 and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company;

Liability for insider trading

Liability for inside trading violations cannot be avoided by passing on the information in an "I scratch your back, you scratch mine" or quid pro quo arrangement, as long as the person receiving the information knew or should have known that the information was company property. It should be noted that when allegations of a potential inside deal occur, all parties that may have been involved are at risk of being found guilty.

For example, if Company A's CEO did not trade on the undisclosed takeover news, but instead passed the information on to his brother-in-law who traded on it, illegal insider trading would still have occurred (albeit by proxy by passing it on to a "non-insider" so Company A's CEO wouldn't get his hands dirty).[5]

Misappropriation theory

A newer view of insider trading, the "misappropriation theory," is now part of US law. It states that anyone who misappropriates (steals) information from their employer and trades on that information in any stock (either the employer's stock or the company's competitor stocks) is guilty of insider trading.

For example, if a journalist who worked for Company B learned about the takeover of Company A while performing his work duties, and bought stock in Company A, illegal insider trading might still have occurred. Even though the journalist did not violate a fiduciary duty to Company A's shareholders, he might have violated a fiduciary duty to Company B's shareholders (assuming the newspaper had a policy of not allowing reporters to trade on stories they were covering)

- **Deemed to be Insiders: Major players of Insider Trading**.

Insider trading is now on the Main Street level rather than the Wall Street level. We're bringing more cases about individuals who know about the companies rather than people involved in the deals.

Buying and selling of securities of any company is a legal activity for everybody. When it comes to insiders such as directors, managers and workers of a company, they can also buy or sell securities of their companies by abiding company’s policy and SEBI’s regulation. Regulation on insider trading clearly says that it will be considered illegal if the insiders of public limited company trade on the basis of price sensitive undisclosed information to make profit or avoid loss. They are expected to trade in securities of their companies for the intention of maintaining the status for long period of time. Trading frequently or entering into reverse transaction at small interval (i.e. less than 6 months) is considered illegal insider trading. Patel committee setup in 1986 on insider trading has defined Insider trading as “Insider trading generally means trading in the shares of a company by the person who are in the management of the company or are close to them on the basis of undisclosed price sensitive information regarding the working of the company, which they possess but which is not available to others”. Logic behind making it illegal is because of insiders access to privileged unpublished price sensitive information. This information put them in an advantageous position. This information can be exploited to make swing profit or insulate loss. As per SEBI guidelines, insiders can trade only after unpublished information is made public and the information is disseminated among public. SEBI has made insider trading regulation very transparent, the insiders will have to report to SEBI and stock exchange whenever there is

[5] Larry Harris, Trading & Exchanges, Oxford Press, Oxford, 2003. Chapter 29 "Insider Trading" p. 589

any change in their position of stock holding. Specific format is prescribed by SEBI for reporting.

A few decades ago, making profit by using insider information was regarded as privilege of the office. Later it was realized that it can be detrimental for future of the stock market. United States was the first country to make a comprehensive legislation on insider trading in Securities Exchange Act 1934. Short swing profit made by buying and selling of securities within a period of 6 month is prohibited. In India, first attempt to curb insider trading was made in 1948 by appointing Thomas committee. Recommendation of the committee was incorporated in the Section 307 and 308 of Companies Act 1956. This section emphasized on various disclosures by directors and managers. The Companies Act was not much effective to stop insiders trading. Subsequently Sachar committee and Patel committee was set up in 1977 and 1986. Along with other recommendations, both the committees recommended formation of separate Statute for curbing insider trading. Another Abid Hussain committee in 1989 recommended that the person should be penalized by both civil and criminal proceeding for insider trading. On the basis of the recommendations by these committees, a comprehensive legislation "SEBI (Insider Trading) Regulations 1992" was brought in force. All the public limited companies have been asked to have a share dealing code. A copy of the same should be handed over to each employee. It is an important code of conduct and its compliance is expected from all the employees. Subsequently the policy was amended in 2002 and renamed as SEBI (Prohibition of Insider Trading) Regulations 1992. The regulation was further amended in 2008 to make the regulation more stringent, more disclosure was made mandatory by the shareholders/insiders

Insiders of the company

Insiders need not be the person who is directly connected to the company because of their position or otherwise. SEBI has defined insider as a person connected to or deemed to be connected and has reasonable connection with unpublished price sensitive data of the company.

- Directors/CEOs/Large shareholders/managers/workers
- Independent non-executive directors, It includes a person who is a connected person six months prior to an act of insider trading
- Share Transfer Agents/registrar to an issue,
- Investment company/trustee company,
- Subsidiary of a company and relatives of connected persons,
- Asset management company,
- Merchant banker/debenture trustee/ broker/sub-broker,
- Portfolio manager/investment adviser/analysts
- Accountancy firms, law firms/consultants or an employee thereof

Price sensitive insider's information

It is the information which is in the hand of insiders and has not been made public. This information can influence market price of the security and generally comes through internal corporate sources. It may affect assets and earnings. On the other hand market information comes from outsiders that may affects price but not assets and earnings. It means such information which is not in the public domain or the market is not aware about it. Such information has a material effect on the price of the shares and the value of the securities of the company. For instance the value of the shares of the company may undergo change after the acquisition or merger of the company. The scope of such information is very wide as there are many microscopic details in the course of the administration of the company which has a direct or indirect impact on the prices of the shares. The ambit of such information is mentioned in a nutshell below.

- A significant business development or a proposed change in the nature of the Company's business
- Details of material contracts that are being negotiated by the Company
- Potential litigation that would have a substantial effect on the Company
- Proposed change in the share capital structure of the Company
- A proposed change in the Company's dividend policy
- A major change to the board or senior management
- Periodical financial results of the Company
- Intended declaration of dividends (both interim and final)
- Issue of securities or buy-back of securities
- Any major expansion plans or execution of new projects
- Amalgamation or mergers or take-over
- Disposal of the whole or substantial part of the undertaking
- Any significant changes in policies, plans or operations of the Company

Price sensitive information" means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company.

The following information would be considered as the price sensitive information within the purview of the SEBI regulations.

- Periodical financial results of the company
- Intended declaration of dividends (both interim and final)
- Issue of securities or buy-back of securities
- Any major expansion plans or execution of new projects
- Amalgamation, mergers or takeovers
- Disposal of the whole or substantial part of the undertaking
- Significant changes in policies, plans or operations of the company

Few examples of Insiders Information

- Periodical financial results
- Intended declaration of dividends
- Issue of securities by way of public/right/bonus etc
- Major expansion plan or execution of new project
- Amalgamation/merger or takeover,
- Disposal of whole or substantial part of undertaking,
- Any significant change in policies, plans or operations of the company.

(The Trading Windows will be closed if any of the above quoted corporate action is to be announced. Insiders cannot deal in securities of the company during this period.)

Insider Trading based on stolen Insider Information:

Regulatory body has yet another challenge to deal with Insider Trading that is based on stolen Information.

An interesting case has revealed wherein a person hacked the computer system of IMS Health, day before it was to announce it's earning, and made huge profit by selling Put option.

PREVENTING INSIDER TRADING

It was only about three decades back that insider trading was recognized in many developed countries as what it was - an injustice; in fact, a crime against shareholders and markets in general. At one time, not so far in the past, inside information and its use for personal profits was regarded as a perk of office and a benefit of having reached a high stage in life. It was the Sunday Times of UK that coined the classic phrase in 1973 to describe this sentiment - "the crime of being something in the city", meaning that insider trading was believed as legitimate at one time and a law against insider trading was like a law against high achievement. "Insider trading" is a term subject to many definitions and connotations and it encompasses both legal and prohibited activity. Insider trading takes place legally every day, when corporate insiders – officers, directors or employees – buy or sell stock in their own companies within the confines of company policy and the regulations governing this trading. It is the trading that takes place when those privileged with confidential information about important events use the special advantage of that knowledge to reap profits or avoid losses on the stock market, to the detriment of the source of the information and to the typical investors who buy or sell their stock without the advantage of "inside" information. Almost eight years ago, India's capital markets watchdog – the Securities and Exchange Board of India organised an international seminar on capital market regulations. Among others issues, it had invited senior officials of the Securities and Exchange Commission to tell us how it tackled the menace of insider trading.

INSIDER TRADING AS A CRIME

Insider trading is an extraordinarily difficult crime to prove. The underlying act of buying or selling securities is, of course, perfectly legal activity. It is only what is in the mind of the trader that can make this legal activity a prohibited act of insider trading. Direct evidence of insider trading is rare. There is no smoking gun or physical evidence that can be scientifically linked to a perpetrator. Unless the insider trader confesses his knowledge in some admissible form, evidence is almost entirely circumstantial. The investigation of the case and the proof presented to the fact-finder is a matter of putting together pieces of a puzzle. This is why providing civil, as well as criminal, liability is vital to an effective insider-trading program.

A few bright illustration of insider trading by deemed to be insiders in India and abroad

1. Former Asia Pacific Head of Alliance Mutual Funds sold large number of shares of Alliance which was under his management; this caused a sharp falls in the valuation of Alliance shares in the market. The person was found guilty of insider trading and banned from trading for 5 years by SEBI.
2. Thomas P. Flanagan, a former partner and vice chairman of Deloitte & Touché and his son was found guilty of concealing the information about his ownership in the securities of audit client. Thomas P. Flanagan was barred from practicing and paid a penalty of $1.1 million.

3. Former First Cash Financial Services chairman Phillip "Rick" Powell is accused of buying 100,000 shares of First Cash through his broker, the day before the company began the buyback. He has entered into the Transaction on the basis of non disclosed information from collateral and payday lending company.
4. Ms Chua Yang Joo, who was with medical device manufacturer Biosensors was charged for insider trading by Monetary Authority of Singapore for trading in shares while in possession of non-public price-sensitive information? A penalty of $77,000 was charged from her.
5. A famous case of insider trading involved co-founder of Galleon hedge fund group Mr. Raj Rajaratnam and Mr Deep Shah an employee of Moody's credit rating agency. Mr. Shah was disclosing confidential and material information that includes mergers, acquisitions and complete corporate financial results before the information was made public from various financial firms to Rajarathanam. Rajarathanam made a profit over $20 million from 2006 through 2009 by trading in the securities on the basis of the information provided by Shah for consideration of cash. Shah has been alleged of selling information about acquisition of Hilton Hotels by the Blackstone Group to an investor Roomy Khan for money.
6. Another famous case of insider trading has come up on the name of housing loan scam. Money Matters a local debt syndication firm promoted by Rajesh Sharma has collected unpublished price sensitive information many companies from Naresh Chandra, secretary (investments) LIC and made huge profit dealing in the securities on the basis of the information.
7. Barclays Bank was charged with insider trading for using private information from the creditors committees of bankrupt companies. Bank employee Steven Landzberg was banks representative in the creditors committee of six financially distressed companies. As a member he came to know all the disclosed and undisclosed private information. Using same information, Mr. Landzberg traded in the debt instruments of the companies and made huge profit for the bank. On investigation, he was found guilty and barred from participating in creditor committees in federal bankruptcy proceedings in future. Barclays bank had to pay a fine of more than $11 million to settle the case of insider trading.
8. A US food and drug administration chemist Chenyi liang and his son Andrew were charged for insider trading. They used information about drug approvals to trade into the securities of the concerned firm and made a profit more than $ 3.7 million.
9. A technology consultant Ms. Winifred Jiau, of Primary Global Research was accused for leaking confidential information about the Marvell Technology Group and Nvidia to hedge funds.
10. In the USA, some cases of insider trading revealed, wherein credit default swap has been used a tool for insider trading. On the basis of information that the particular company won't be able to pay its debts, insiders bought CDS and made huge profit.
11. There are also cases wherein insiders like entrepreneurs and venture capitals have made profit by taking advantages of insider information in the first year of floatation of IPO.
12. A few cases of insider trading by Fund manager of Mutual funds has come to light. SEC has alleged that fund managers violated rules for selective disclosure of fund portfolio holdings to arbitrageurs

Insider Trading in International Perspective: A Comparative Study

➢ **Insider Trading Law in the United States**

Rooted in the common law tradition of England, on which our legal system is based, we have relied largely on our courts to develop the law-prohibiting insider trading. While Congress gave us the mandate to protect investors and keep our markets free from fraud, it has been our jurists, albeit at the urging of the Commission and the United States Department of Justice, who have played the largest role in defining the law of insider trading.

After the United States stock market crash of 1929, Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934, aimed at controlling the abuses believed to have contributed to the crash. The 1934 Act addressed insider trading directly through Section 16(b) and indirectly through Section 10(b). Section 16(b) prohibits short swing profits (profits realized in any period less than six months) by corporate insiders in their own corporation's stock, except in very limited circumstance. It applies only to directors or officers of the corporation and those holding greater than 10% of the stock and is designed to prevent insider trading by those most likely to be privy to important corporate information. Section 10(b) of the Securities and Exchange Act of 1934 makes it unlawful for any person "to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." To implement Section 10(b), the SEC adopted

Rule 10b-5, which provides, in relevant part:
It shall be unlawful for any person, directly or indirectly,

A. To employ any device, scheme, or artifice to defraud,

B. To make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

C. To engage in any act, practice, or course of business this operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of a security.

These broad anti-fraud provisions make it unlawful to engage in fraud or misrepresentation in connection with the purchase or sale of a security. While they do not speak expressly to insider trading, here is where the courts have exercised the authority that has led to the most important developments in insider trading law in the United States.

The breadth of the anti-fraud provisions leaves much room for interpretation and the flexibility to meet new schemes and contrivances head on. Moral imperatives have driven the development of insider trading law in the United States. And the development of insider trading law has not progressed with logical precision as the reach of the anti-fraud provisions to cover insider trading has expanded and contracted over time. The anti-fraud provisions were relatively easy to apply to the corporate insider who secretly traded in his own company's stock while in possession of inside information because such behaviour fit within traditional notions of fraud. Far less clear was whether Section 10(b) and Rule 10b-5 prohibited insider trading by a corporate "outsider." In 1961, in the case of

In re ***Cady Roberts & Co.***[6] the Securities and Exchange Commission, applying a broad construction of the provisions, held that they do. The Commission held that the duty or obligations of the corporate insider could attach to those outside the insiders' realm in certain circumstances.

Analytically, the obligation [not to engage in insider trading] rests on two principal elements: first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing. In considering these elements under the broad language of the anti-fraud provisions we are not to be circumscribed by fine distinctions and rigid classifications.

Thus, it is our task here to identify those persons who are in a special relationship with a company and privy to its internal affairs, and thereby suffer correlative duties in trading in its securities. Intimacy demands restraint lest the uninformed be exploited. Based on this reasoning, the Commission held that a broker who traded while in possession of non public information he received from a company director violated Rule 10b-5. The Commission adopted the "disclose or abstain rule": insiders, and those who would come to be known as "temporary" or "constructive" insiders, who possess material non public information, must disclose it before trading or abstain from trading until the information is publicly disseminated.

Several years later in the case of ***SEC v. Texas Gulf Sulphur Co.*** a federal circuit court supported the Commission's ruling in Cady, stating that anyone in possession of inside information is required either to disclose the information publicly or refrain from trading[7]. The court expressed the view that no one should be allowed to trade with the benefit of inside information because it operates as a fraud all other buyers and sellers in the market[8]. This was the broadest formulation of prohibited insider trading. The 1980s were an extraordinary time in this country's economic history, marked by a frenzy of corporate takeovers and mergers involving what then were dazzling amounts of money.

Insider trading reached new heights. Ironically, it is during this period that courts narrowed the scope of Section 10(b) and Rule 10b-5 in the insider trading context.

In the 1980 case of ***Chiarella v. United States***, the United States Supreme Court reversed the criminal conviction of a financial printer who gleaned non public information regarding tender offers and a merger from documents he was hired to print and bought stock in the target of the companies that hired

[6] 40 SEC 907 (1961).

[7] 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

[8] 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

him[9]. The case was tried on the theory that the printer defrauded the persons who sold stock in the target to him. In reversing the conviction, the Supreme Court held that trading on material non public information in itself was not enough to trigger liability under the anti-fraud provisions and because the printer owed target shareholders no duty, he did not defraud them. In what would prove to be a prophetic dissent, Chief Justice Burger opined that he would have upheld the conviction on the grounds that the defendant had "misappropriated" confidential information obtained from his employer and wrongfully used it for personal gain.

In response to the Chiarella decision, the Securities and Exchange Commission promulgated Rule 14e-3 under Section 14(e) of the Exchange Act, and made it illegal for anyone to trade on the basis of material non public information regarding tender offers if they knew the information emanated from an insider[10]. The purpose of the rule was to remove the Chiarella duty requirement in the tender offer context – where insider trading was most attractive and especially disruptive.

In 1981, the Second Circuit adopted the "misappropriation" theory, holding in the case of

United States v. Newman[11] that a person with no fiduciary relationship to an issuer nonetheless may be liable under Rule 10b-5 for trading in the securities of an issuer while in possession of information obtained in violation of a relationship of trust and

Three years later in **Dirks v. SEC**[12]**,** the Supreme Court reversed the SEC's censure of a securities analyst who told his clients about the alleged fraud of an issuer he had learned from the inside before he made the facts public. Dirks were significant because it addressed the issue of trading liability of "tippers": those who receive information from the insider tipper. Dirks held that tippers are liable if they knew or had reason to believe that the tipper had breached a fiduciary duty in disclosing the confidential information and the tipper received a direct or indirect personal benefit from the disclosure. Because the original tipper in Dirks disclosed the information for the purpose of exposing a fraud and not for personal gain, his tipper escaped liability.

A significant aspect of the decision was contained in a footnote to the opinion, which has come to be known as "Dirks footnote 14." There, Justice Powell formulated the concept of the "constructive insiders" – outside lawyers, consultants, investment bankers or others – who legitimately receive confidential information from a corporation in the course of providing services to the corporation. These constructive insiders acquire the fiduciary duties of the true insider, provided the corporation expected the constructive insider to keep the information confidential.

The Second Circuit again addressed the misappropriation theory in the 1986 case of *United States v. Carpenter*[13]. The case centered on a columnist for the Wall Street Journal, whose influential columns often affected the stock prices of companies about which he wrote. The columnist tipped information about his upcoming columns to a broker (among others) and shared in the profits the broker made by trading in advance of TV Journalist is Accused of Insider Trading, AP World stream, August 17, 1998, financial pages publication[14] In upholding the convictions of the columnist and the broker for securities fraud under Rule 10b-5 and mail and wire fraud, the Second Circuit rejected the defendants' argument that the misappropriation theory only applies when the information is misappropriated by corporate or constructive insiders, holding "the misappropriation theory more broadly proscribes the conversion by insiders' or others of material non-public information in connection with the purchase or sale of securities[15]."

The case was appealed to the Supreme Court. The Supreme Court unanimously agreed that Carpenter engaged in fraud, but divided evenly on whether he engaged in securities fraud[16]. But in unanimously affirming the mail and wire fraud convictions, the Court quoted an earlier New York decision that ruled: "It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal

[9] 445 U.S. 222 (1980).
[10] The Commission's authority to promulgate rules under Section 14(e) of the Exchange Act is confined to the tender offer context.
[11] 463 U.S. 646 (1983).
[12] 31 791 F.2d 1024 (2d Cir. 1986), aff'd 484 U.S. 19 (1987).

[13] Echoing the Carpenter case, German prosecutors reportedly are considering bringing insider tradingcharges against a German television journalist, known as "Germany's first international stock market guru,"
[14] 791 F.2d at 1029
[15] 484 U.S. 19, 24 (1987).
[16] Diamond v. Oreamuno, 248 N.E. 2d 910, 912 (N.Y. 1969).

benefit but must account to his principle for any profits derived therefrom[17]."

Over the next nine years, the misappropriation theory gained acceptance in federal courts[18]. Then in 1995 and 1996, two federal circuit courts rejected the misappropriation theory[19] on the grounds that the theory "requires neither misrepresentation nor nondisclosure" and that "the misappropriation theory is not moored in [section] 10(b)'s requirement that the fraud be "in connection with the purchase or sale of any security."

Last year, in a landmark victory for the SEC, the Supreme Court reversed one of these decisions and explicitly adopted the misappropriation theory of insider trading in the case

The "misappropriation theory" holds that a person commits fraud "in connection with" a securities transaction, and thereby violates 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information. Under this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of the information. In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary- promote investor confidence. Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated non-public information is unchecked by law. An investor's informational disadvantage vis-à-vis a misappropriate with material, non-public information stems from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill[20].

[17] SEC v. Materia, 745 F.2d 197, 201 (2d Cir. 1984); Rothberg v. Rosenbloom, 771 F.2d 818 (3d Cir. 1985); SEC v. Cherif, 933 F.2d 403 (7th Cir. 1990); SEC v. Clark, 915 F.2d 439 (9th Cir. 1990).

[18] United States v. Bryan, 58 F.3d 933, 944 (4th Cir. 1995); United States v. O'Hagan, 92 F.3d 612 (8th Cir.1996).

[19] United States v. O'Hagan, 117 S.Ct. 2199, 2211 (1997) (quoting the Eighth Circuit's opinion in O'Hagan,92 F.3d at 618).21 117 S. Ct. 2199 (1997) of *United States v. O'Hagan*22.

[20] Council Directive 89/592 Coordinating Regulations on Insider Trading, 1 Common Mkt. Rep. (CCH) 1761 ("EC Directive").

Second, the Court acknowledged the "information as property" rationale-underlying insider trading prohibitions:

A company's confidential information qualifies as property to which the company has a right of exclusive use. The undisclosed misappropriation of such information in violation of a fiduciary duty constitutes fraud akin to embezzlement – the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another[21].'

Although the law of insider trading in the United States is continuing to evolve, the decision in O'Hagan is a significant milestone in defining the scope of Rule 10b-5 insider trading prohibitions.

- **The European Community Directive on Insider Trading**

As United States lawmakers, courts and regulators struggled to refine prohibitions on insider trading, insider trading in the rest of the world markets, with few exceptions, went virtually unregulated prior to the 1980s. The first wide-ranging development outside the United States in efforts to ban insider trading was the European Community Directive Coordinating Regulations on Insider Trading, adopted on November 13, 1989 (the "EC Directive")[22]. The EC Directive arose out of the 1957 Treaty of Rome Establishing the European Economic Community, which mandated creating a single internal European financial market[23].

In the 1980s, highly publicized insider trading scandals in New York involving Ivan Boesky and Michael Milken, among others, and in Europe involving the Guinness brewing group, gave a new urgency to developing a European-wide ban on insider trading[24].

The Directive was modelled after French and English insider trading prohibitions and went through a number of incarnations. In its final form, the Directive has an appealing structural simplicity. In sum, It defines "inside information" as information of a "precise nature" about security or issuer which has not been made public which, if it were made public,

[21] See Warren, The Regulation of Insider Trading in the European Community, 48 Wash. & Lee L. Rev. 1037 (1991).

[22] Council Directive 89/592 Coordinating Regulations on Insider Trading, 1 Common Mkt. Rep. (CCH) 1761 ("EC Directive").

[23] The Regulation of Insider Trading in the European Community, 48 Wash. & Lee L. Rev. 1037 (1991).

[24] William Dawkins and Hugo Dixon, EEC Proposes Action on Insider Trading, The Financial times (London), April 29, 1987, at § I, 48.

"would likely have a significant effect on the price" of the security

A fundamental difference between the EC Directive and the United States' prohibition against insider trading under Section 10b and Rule 10b-5 as developed by the courts is that the Directive does not require that the insider trader breach a fiduciary duty to the source of the information for liability to attach. In this respect, it mirrors the United States' prohibition against trading on the basis of non-public information about a tender offer under Section 14(e) of the Securities Exchange Act of 1934 and the Commission's Rule 14e-3.

As noted, the Supreme Court recently upheld this rule in the O'Hagan case.

It is too soon to make any intelligent generalizations about how legislation modelled on the Directive has fared jurisprudentially. In the scheme of things, insider-trading laws fashioned under the Directive are in their infancy. At the time the Directive was passed, four of the 12 members of the EC – West Germany, Belgium, Italy and Ireland – had no insider trading legislation on the books and the remaining eight members – France, England, Luxembourg, the Netherlands, Denmark, Greece, Portugal and Spain – had widely varying statutes[25]. Several of the members took time well beyond the 1992 deadline to get legislation in place. Luxembourg, for example, enacted its version of the Directive just last year[26]. And, obviously, the statutes are not self-enforcing – getting them on the books is only the first step to effecting a change in practice. Germany and Italy, in particular, have had trouble surmounting cultures, which traditionally viewed insider trading as an acceptable practice. One commentator recently observed as to Italy "In spite of the passage of laws on takeovers and insider trading since 1992, the bourse has not shaken its reputation as a fiefdom of an inward-looking financial community that treats small shareholders shabbily[27]." By contrast, Chairman Levitt recently observed as to the U.S. markets: "Individual investors think – and I passionately believe – that the proverbial little guys' on Main Street should have the same fair chance as the big guys[28].'"

- **Cooperation Among International Enforcement Authorities**

Insider trading often crosses borders: a foreign national engages in insider trading in the domestic market; nationals affect insider trading through foreign accounts or important evidence of domestic insider trading lies outside domestic borders. Successful investigations and prosecutions of these cases require international cooperation. Perhaps one the most progressive aspects of the EC Directive is that it requires members to cooperate with each other "whenever necessary for the purpose of carrying out their duties" in connection with the EC Directive. The significant benefit of this provision is that it requires no further agreements between or among states regarding cooperation.

The SEC has entered into36 arrangements with foreign counterparts for information sharing and cooperation in the investigation and prosecution of securities law violations. These agreements have taken primarily two forms: Mutual Legal Assistance Treaties in Criminal Matters and Memoranda of Understanding. The United States has entered into Mutual Legal Assistance Treaties have been entered into with a number of countries, including Switzerland, the United Kingdom and Northern Ireland, the Cayman Islands, the Netherlands, Turkey, Canada, the Bahamas and Italy. The treaties generally provide for assistance in criminal matters, including assistance in locating witnesses, obtaining statements and testimony of witnesses, production and authentication of business records and service of judicial and administrative documents. The major advantage of these treaties is that they are binding on the parties to the treaty. The other form of agreement the United States has relied on in the international context is the Memorandum of Understanding. MOUs are non-binding statements of intent between regulators providing for the exchange of information and mutual cooperation. The Commission has entered 36 Echoing the Carpenter case, German prosecutors reportedly are considering bringing insider trading charges against a German television journalist, known as "Germany's first international stock market guru," for allegedly telling his friends which stock he was going to recommend on his weekly program. German TV Journalist is Accused of Insider Trading, AP World stream, August 17, 1998, financial pages. into

[25] Tim Dickson, Ensuring the 1992 Programme Isn't A Spivs' Charter; The European Market, Financial Times, June 19, 1989, § I, at 2.

[26] Insider Trading Accord Creates Dual Definitions for Insider, Eurowatch, Financial Services, Vol. 9, No. 16, October 17, 1997.

[27] Robert Graham, New Broom for Bourse: The Head of Italy's Stock Market Watchdog Outlines His Plans, Financial Times (London Edition), March 24, 1997, at 22.

[28] Arthur Levitt, A Question of Investor Integrity: Promoting Investor Confidence by Fighting Insider Trading, Address Before the "SEC Speaks" Conference, February 27, 1998.

MOUs or similar agreements with Switzerland, Japan, the U.K., Brazil, the Canadian Provinces of Ontario, Quebec and British Columbia, Italy, the Netherlands, France, Mexico, Portugal and Germany. Experience has shown that MOUs provide an effective means of obtaining information in securities enforcement and assist in developing a framework for cooperation and improved communication. Domestically, the United States has passed laws to facilitate its cooperation with foreign governments. The Insider Trading and Securities Fraud Enforcement Act of 1988 expanded the Commission's ability to provide assistance to foreign regulators by allowing it to use its compulsory powers to compel testimony and production of documents obtain information at the request of a foreign securities authority. The International Securities Enforcement Cooperation Act of 1990 enlarged the Commission's ability to address international securities issues in several ways. It amended the securities laws to permit the Commission to institute an administrative proceeding barring, sanctioning, or otherwise placing conditions on a securities professional's ability to engage in Commission-regulated activities if a foreign court or securities authority has found that the professional engaged in illegal or improper conduct. The law also amended the securities laws to provide confidential treatment for records produced under reciprocal arrangement with foreign securities authorities by exempting the documents from the disclosure obligation of the Freedom of Information Act if a good faith representation is made that disclosure would violate that country's confidentiality requirements. In addition, the law makes explicit the Commission's rulemaking authority to provide access to non public documents and other information to both foreign and domestic authorities.

Finally, it authorizes the Commission to accept reimbursement from a foreign securities authority for expenses incurred by the Commission in providing assistance. In 1997, the SEC made 240 requests to foreign governments for enforcement assistance and responded to 363 requests for enforcement assistance from foreign governments[29]. In the summer of 1998, the SEC had a notable success in obtaining information under the Hague Convention, which prescribes certain procedures by which a judicial authority in an emergency action filed in the Southern District of New York, the Commission filed a complaint against two Singapore residents, alleging that the defendants engaged in insider trading prior to the public announcement that APL Limited would be acquired by Singapore-based Neptune Orient Lines, Ltd. The court granted the Commission's request for a temporary asset freeze and orders requiring the defendants to identify themselves, allowing expedited discovery, and granting other ancillary relief[30]. The Commission applied to the High Court of the Republic of Singapore under the Hague Convention for the appointment of an examiner to take evidence from witnesses in Singapore to be used in the proceeding in the Southern District of New York. The Singaporean defendants opposed the appointment of an examiner, arguing that despite the U.S. classification of the action as civil, violations of Section 10(b) and Rule 10b-5 are penal in nature and, therefore, the Hague Convention does not apply. The Singapore court held for the SEC, finding that an action for an injunction under Section 10(b) and Rule 10b-5 is a civil proceeding according to the law of the United States and the law of Singapore. This decision, if followed in other Hague signatory countries, opens yet another mode of international information gathering available to the SEC's enforcement program.

SEBI on Insider Trading

By investing in a company's share, an investor (share holder) becomes an owner of that particular company to the extent of the value of the shares held by him. He therefore is entitled to a share in the profits earned by the company. This share in profits that is distributed to a shareholder is known as dividends. Apart from the ownership, it is the dividend or the anticipation thereof that lures an investor into buying the shares of a particular company. The performance of a company is of primary importance to the investors and the general public who might invest in the company. The Indian company law provides that a company should prepare an annual account showing the company's trading results during the relevant arrear (section 210, Companies Act, 1956).It also makes it mandatory that the company publishes its assets and liabilities at the end of the period along with the financial results. This has been provided to ensure transparency in the functioning of the company which the shareholders also have a right to know. Also, action 166 provides that the company calls at least one meeting of its shareholders each year. This meeting is known as the Annual General Body Meeting (AGM) and is kept with a view to ensure that the shareholders come together once in a

[29] Annual Report of the Securities and Exchange Commission to the United States Congress for Fiscal Year1997 one contracting state may request evidence located in another contracting state in civil cases

[30] SEC v. One Unknown Purchaser of the Call Options of APL Limited and Ong Congqin Bobby, 97 Civ. 2664 (S.D.N.Y. April 15, 1997), Litig. Rel. No. 15334.

year to ensure and review the working of the company. The information released in Annual Reports and Annual General Body Meetings relate to the performance of the company and hence play a valuable role in shaping the minds of existing and prospective shareholders.

The General public and shareholders get knowledge of this information only during AGM or Annual Reports or when the company announces it in a press conference etc. However persons in the company itself or otherwise concerned to the company are in possession of such information before it is actually made public. For example, a Chartered Accountant was auditing the accounts of the company, a lawyer giving the company any advice on its future endeavors, directors of the company taking decisions etc. come into possession of knowledge on the company's performances.

The knowledge of this unpublished price sensitive information in hands of persons connected to the companies puts them in an advantageous position over others who lack it. Such information can be used to make gains by buying shares a cheaper rate anticipating that it might rise. Similarly, it can be used to insulate themselves against losses by selling shares before the prices fall down. Such transaction entered into by persons having access to any unpublished information is called Insider Trading. Such trading is not based on a level playing field and can prove detrimental to the interests of the shareholders of the company. Consequently, SEBI banned insider trading and laid down the SEBI (Prohibition of Insider Trading) Regulation 1992.

Regulation 2(e) defines an 'insider' as a person connected or deemed to be connected and who is reasonably expected to have access to any unpublished price sensitive information in respect of securities [i.e. shares, debentures etc.] of a company, or who has received or has had access to such unpublished information. The directors, officer, employers of the company, & persons involving a professional or business relationship [like CA's lawyers etc.] are connected person as per regulations 2 (c). The definition of person would include a company, association or body of individuals whether incorporated or not. Apart from connected persons, the regulation also provides for 'deemed to be connected persons' who generally include intermediaries like an investment company, Trustee Company etc. Also included in the list is subsidiary of a company and relatives of connected persons etc. It is important to note here that an employee, director or officer of a company does not become a connected person solely by virtue of his position in the company. To be considered as a connected person, it is important to prove that they have indulged in insider trading. Regulation 2(ha) defines price sensitive information as any information which relates directly or indirectly to a company, and if published, would substantially affect the price of securities of the company. It also provides a list of information that it deems to be price sensitive information which includes:-

- Ø Periodical financial result of the company. Ø Intended declaration of dividends. Ø Issue or buy–back of securities. Ø Any major expansion plans or execution of new projects. Ø Amalgamation, mergers or takeovers, Ø Disposal of the whole or substantial part of the undertaking Ø Any significant change in policies, plans or operation of the company

A mere perusal of the list gives an impression that a price sensitive information would be any information that has direct nexus with the performances of the company in present and future time. Regulation 3 & 3A enumerates the various acts that an insider and company are prohibited to do. These regulations prohibit an insider and a company to 'deal' in certain circumstances. The term 'deal' is defined under regulation 2(d) which describe dealing in securities to mean an act of subscribing, buying, selling or agreeing to do so by any person either as principal or agent.

- Regulation 3 prohibits an insider to deal either on his behalf or on behalf of any other person in the securities of a company listed on a stock exchange when in possession of unpublished price sensitive information. It also prohibits the communication, procurement, counseling of such information directly or indirectly in writing or verbally unless such communication has been made in the ordinary course of business, profession, employment or under any law. Regulation 3A puts a similar prohibition on companies to deal in securities of another company or an associate of that company when in possession of unpublished price sensitive information. However, Regulation 3B provides that if the company proves that though the transaction was entered by an officer on its behalf, he was not aware of any such information. In such a case the company will not be held guilty of insider trading. It also provides with some other defenses which a company may advance in a proceeding for an offence under Regulation 3A.
- Thus, Regulation 3 & 3A provides the acts that an insider or company is prohibited to enter into.

Contravention of this provision shall amount to insiders trading and is punishable as per section 24 of SEBI Act, 1992. The section provides for a punishment of imprisonment for a term up to 10 years or a fine up to Rs. 25 Crores or both.

- The SEBI (Prohibition of Insider Trading Regulation), 1992 also provides for certain measures that every listed company and other entities need to incorporate to facilitate prevention of insider trading.
- Regulation 13 provides that any person holding more than 5% shares or voting right in any listed company shall disclose to the company the number of shares or voting rights held by him. It also requires a director to inform the company about the number of shares or voting rights held by him within 4 days of his appointment. It also requires such shareholders and directors to make continuous declaration of any change in their share holding or voting rights to the company. The company in return is required to disclose such information received to all stock exchanges where the company is listed.
- Regulation 12 requires all listed companies and organizations associated with securities to frame a code of internal procedure. The regulation also provides a models code to which the internal procedure should be in consonance. The model code provides that a listed company shall appoint compliance officer who shall set forth policies, procedures and also monitor adherence to the rules for preservation of price sensitive information. It also lays down certain trading restrictions that all directors, officers and designated employees are subject to. Designated employees are officers comprising the top three tiers of the company's management or the employers designated by the company to whom the restrictions shall be applicable. It provides that such directors, officer and employees shall be eligible to deal in securities only during a trading period known as "Trading windows", which shall be close at the time of:-

Ø Declaration of financial results.
Ø Declaration of dividends.
Ø Issue of securities by way of public/right/bonus etc.
Ø Major Expansion plans or execution of new projects.
Ø Amalgamation, mergers, takeovers and buy back.
Ø Disposal of whole or substantial part of the undertaking.
Ø any changes in plans, policies or operation of the company.

The directors, employees or officers of a company shall only be eligible to deal in securities when the trading windows are open.

It also provides that the directors etc. wanting to deal in the securities of the company beyond a threshold limit, which shall be decided by the company, a pre clearance of the same must be taken from the compliance officer. The deal should be affected within 7 days of pre-clearance failing which a fresh clearance is required.

The model code also provides for prevention of insider trading in other entities that may come in possession of unpublished price sensitive information due to their nexus to a listed company. It provides that such entities should adopt the 'Chinese Wall' policy which demarcates the area of the organization having access to confidential information- known as 'Inside area'- from other areas of the organization – known as 'public area'. The employees in inside area shall not communicate any information to an employee in public area. It provides that in order to monitor Chinese wall policy and trading in client securities based on insider information, the organization / firm shall restrict trading in certain securities and designate such list as restricted / grey list. Trading in any security on the restricted list by designated employees, directors etc. may be blocked or disallowed during pre- clearance. The SEBI 'has been indeed circumspect in formulating this regulation. It covers all possible incidences of insider trading and also provides for measures that facilitates its prevention. Thus it will not be wrong to say that SEBI has ensured a level playing field for all shareholders of a company who otherwise would have been at a loss in the absence of such regulations. These regulations have also ensured that insider does not undermine the interests of small shareholders in his endeavour to make profits or insulating himself against a

- **Highlights of SEBI Regulation on insider trading:**

In line with Regulators all over the world, SEBI has also tightened regulation on insiders trading. It has broadened the definition of deemed to be insiders. As per new regulation one can be in the ambit of deemed to be insiders if he or she has access to unpublished price sensitive information even if not connected directly to the company. Highlight of the policy is as below:-

1. No insider will trade either on his own behalf or on behalf of any other person into the securities of any listed company if he or she has any unpublished information pertaining to the company with him.

2. Insider should not communicate any price sensitive with anybody unless the same is required for ordinary course of business.
3. If a person acquires 5% shares or voting right of any listed company, the same has to be disclosed to SEBI and Stock Exchanges within a period of 4 days.
4. On appointment of a director or an officer of a listed company, the person need to disclose SEBI and Stock Exchange about number of share held by him within 4 days of appointment.
5. Whenever there is a change in the position of holding by a person who holds more than 5% shares or voting right of the company.
6. When the change in the holding position of any officer or director exceeds by Rs 5 lakhs in value or 5000 shares or 2% of voting rights.
7. No company shall deal in the securities of any other company while in possession of any unpublished price sensitive information.
8. Insiders such as, directors, officers and employees of the company are eligible to buy or sell the securities when Trading Windows are open. Pre clearance from compliance officer is required if deal is for beyond threshold limit. The deal should be completed within 7 days of the clearance from compliance officer. Trading Windows will be closed if any corporate action is expected.
9. SEBI has prescribed format A, B, C and D for various reporting and disclosure by the insiders.

- **Rights and Powers of the SEBI related to insider trading in brief**

Right of SEBI to Investigate

The Board may appoint investigating authority to investigate into the complaints received from investors, intermediaries or any other person on any matter having a bearing on the allegations of insider trading; AND To investigate suo-moto upon its own knowledge or information in its possession to protect the interest of investors in securities against breach of these regulations.

Procedure for Investigation

On Complaints / Suo-moto On Conclusion Report to Board will Issue directions Investigation Started Appointment of Invite. Auth. Notice Issued to provide all assistance shall reply within 21 days Findings to suspected person Procedure for Investigation Reg 6 - 9

Directions by SEBI

Reg 11 Directions by Board INDEPENDENT of right to Initiate Criminal proceedings OR any action under Chapter VIA of the Act (Penalties & Adjudication), May Direct Not to deal in securities Prohibition on Disposal Restraining to Communicate or Counsel Declare transaction as null & void To deliver securities back to the seller Or market price equivalent be paid to the seller To transfer the proceeds to the Investor Protection Fund of Stock Exchange

Disclosures to be made

Reg 13(1) Disclosures To be Made PARTICULARS TO BE SUBMITTED To PERIOD Initial disclosure by person who holds more than 5% shares/ voting rights in any listed company within 4 working days of receipt of information of allotment or the acquisition of shares/voting right To Intimate The number of shares held by such persons

Reg 13(2) Disclosures To be Made PARTICULARS TO BE SUBMITTED To PERIOD Initial disclosure by person who is either director or officer of listed company within 4 working days of becoming the director or officer of company To Intimate The number of shares held by such persons

Reg 13(3 & 5) Disclosures To be Made PARTICULARS TO BE SUBMITTED To PERIOD Continual disclosure by person who holds more than 5% shares/ voting rights in any listed company within 4 working days of receipt of information of allotment or the acquisition of shares/voting right To Intimate The number of shares held & any Change exceeding 2%

Reg 13(4 & 5) Disclosures To be Made PARTICULARS TO BE SUBMITTED To PERIOD Continual disclosure by person who is either director or officer of listed company within 4 working days of receipt of information of allotment or the acquisition of shares/voting right To Intimate The number of shares held & any Change exceeding Rs. 5 Lakh OR 25000 Shares OR 1% whichever is Lower

Modal Code of Conduct

Code of Conduct to be Abide by Reg 12 All Listed Companies Organizations Associated with Securities Markets including: All intermediaries AMC and trustees of mutual funds; The Self Regulatory Organizations; the Stock Exchanges / Clearing House / Corporations; The Public Financial Institutions the Professional Firms Such as Auditors, Accountancy Firms, Law Firms, Analysts, Consultants, etc., Assisting or Advising Listed Companies

IMPORTANT TERMS PRE CLEARANCE OF TRADES

Company shall specify a trading period, to be called & quot; Trading Window & quot; for trading in the company's securities. The trading window shall be closed during the time the Price Sensitive information is un-published. When the trading window is closed, the D/ E /O shall not trade in the company's securities in such period. The trading window shall be opened 24 hours after the Price Sensitive Information is made public.

Model Code of Conduct IMPORTANT TERMS TRADING WINDOW

To restrict trading in certain securities and designate such list as restricted / grey list. Client Companies for which any assignment or appraisal report or credit rating assignments are going on. Any security which is purchased or sold by the organisation / firm on behalf of its clients / schemes of mutual funds, etc. shall be put on the restricted / grey list. As the restricted list itself is highly confidential information, it shall be maintained by Compliance Officer.

Model Code of Conduct IMPORTANT TERMS COMPLIANCE OFFICER (CO)

Code provides Penalty and Appropriate action by the company for violations of code. Disciplinary action by the company, include wage freeze , suspension, ineligible for future participation in ESOP etc The action by the company shall not preclude SEBI from taking any action in case of violation of SEBI (Prohibition of Insider Trading), Regulations, 1992. Model Code of Conduct IMPORTANT TERMS PENALTY FOR CONTRAVENTION OF CODE OF CONDUCT

Action by SEBI against Violations

- Take actions to Prohibit Insider Trading – U/s 11. Issue directions in Interest of Investors & Securities Market
- U/s 11B Impose Penalty (25 Crore) / Imprisonment (10 Years)
- U/s - 24 Reg 14 GENERAL ACTION AGAINST VIOLATIONS
- Sec.15 G of SEBI SPECIFIC ACTION AGAINST VIOLATIONS APPLICABILITY: Any Insider Who Deals in Securities based on any UPSI. Communicates any UPSI to any person, with or without his request Counsels / procures to deal in Securities Based on UPSI. PENALTY: Rs. 25 Crore OR 3 times the amount of profit made whichever is HIGHER prospective loss.

CIVIL SANCTIONS

There is a need to add heavy civil consequences on the insider trader. According to SEBI, it does not have the power to impose civil penalties on the violator but SEBI could seek civil powers over violators with assistance from civil courts. S. 11 of the SEBI Act gives the Board broad discretionary powers to issue appropriate remedies. To quote "Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities **market**, by such measures as it thinks fit". It also has the powers to issue to any person connected to the securities **market** such directions "as may be appropriate in the interests of the investors in securities". ***SEBI has, like Harry Potter, powers it does not know of.***

CRIMINAL SANCTIONS

Of course there is the usual threat of a jail sentence for the offender under S.24 of the SEBI Act. The section is more of a paper tiger. Though the jail sentence may look good on the statute, history bears out the difficulty in enforcing criminal prosecution against an economic offender. The burden of proof of proving a criminal charge is so onerous that a matter lies in the courts to unravel the complicated issues of facts of illegal transactions consummated over a period of time.

OTHER SANCTIONS

The ***Securities and Exchange Board of India*** may without prejudice to its right to initiate criminal prosecution under section 24 or any action under **Chapter VIA of the SEBI Act**, to protect the interests of investors and in the interests of the securities **market** and for due compliance with the provisions of the Act, Regulations made there under issue any or all of the following order, namely: -

A. directing the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act not to deal in securities in any particular manner;

B. Prohibiting the insider or such person as mentioned in clause (i) of sub-section (2) of section 11 of the Act 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;

F. Directing the person who has dealt in securities in violation of these regulations to transfer an amount or proceeds equivalent to the cost price or market price of securities, whichever is higher to the investor protection fund of a Recognized Stock Exchange?

PROPHYLACTICS AND CORPORATE GOOD GOVERNANCE

The 2002 amendments to the Regulations provide extensive suggestions and also extensive regulations couched in the language of corporate good governance. Corporate good governance has been married to the penal provisions of the regulations provided by SEBI to create a smothering framework of regulations.4 Of course there is no denying that the regulations create a fair market and create a framework which more and more western countries are moving towards.

SARBANES-OAXLEY ACT

The US legislature, witness to an unending line of scandals, recently passed amendments to the securities/disclosure laws of the country – in effect codifying into law several corporate governance suggestions made on previous occasions. The Sarbanes- Oaxley Act of 2002 requires:

- Directors, executive officers and large shareholders of public issuers to report transactions in the issuer's equity securities within two business days of a transaction.
- pre-clearance procedures for transactions in the issuer's equity securities;
- the responsibilities the company will take for completing filings;
- the requirement (or encouragement) to use a specified broker for transactions in the issuer's securities, or the certifications required from brokers if no specific broker is required;
- the applicability of the rules to persons with business or family relations to the insider; and
- Sanctions for failure to make timely filings.

- **SOME POSSIBLE ADDITIONS TO THE ALREADY EXISTEING REGULATIONS:**

Short swing profits

There should be a regulation introduced in the Insider Trading regulations which compel an insider to disgorge or turn in profits made by insiders to the company for any transaction in equity based securities in the company's securities (including its parent's or subsidiary's shares) if both the buy and sell side of the transaction is entered into within six months of the other.

Designated or qualified brokers

Issuers should either designate a single broker through whom all transactions in issuer stock by insiders must be completed or require insiders to use only brokers who will agree to the procedures set out by the company. A designated broker can help ensure compliance with the company's pre-clearance procedures and reporting obligations by monitoring all transactions and reporting them promptly to the issuer.

Derivatives amendments

Parts of the regulations refer to 'shares' for the purpose of proscription while they should prohibit "securities" trading. For instance, one could, using derivatives, economically sell the shares without physically trading in those shares. Similarly, one can easily create synthetic securities with the same economic impact as an equity share of a company. By reclassifying shares into securities, one can eliminate the problem because securities are defined to include equity, quasi-equity, derivatives and any combination of the three. Pure debt instruments can be excluded specifically from the regulations.

Civil penalties

SEBI should be specifically provided with powers to charge several times the profit made (or loss avoided) and provide an economic blow to an economic offence. People trading in the **market** (not just counter parties to the insider) should also have specific powers to rescind trades and charge damages to the insiders during the period when they traded.

Proactive Stock Exchanges

The stock exchanges should take up at least a substantial burden of filing action against persons violating the regulations. Since the Rules and regulations of the stock exchanges are tabled in parliament, and court judgments have found the regulations having the force of law – they could easily enforce the requirements of the listing terms or the rules and regulations by seeking civil action in courts against persons or companies who violate such regulations.

Recession

One author has suggested that a contract of sale or purchase by an insider be declared void by the counterparty to a trade under the Indian Contract Act (this is besides the powers SEBI has to annul the trade under Regulation 11). Though legally feasible, it raises impossible burdens in today's virtually anonymous **capital market**s.

Tippee liability

The regulations prohibit persons from tipping people about inside information by insiders i.e. the tipper. However, there seems to be no liability for a person who improperly receives a tip i.e. a tipped from trading. There is a vague prohibition against 'procurement' of information. However, it does not clearly prohibit a tipped from trading.

Bounty system

Section 21A (e) of the American Securities Exchange Act of 1934 authorizes the Securities and Exchange

Commission to award a bounty to a person who provides information leading to the recovery of a civil penalty from an insider trader, from a person who "tipped" information to an insider trader, or from a person who directly or indirectly controlled an insider trader. This could be a useful addition to cracking into new cases of insider activity.

Disgorgement

Disgorgement orders could be obtained by SEBI from courts so that the ill gotten gains or the losses avoided can be taken away from the offender. A five times penalty or a ten times the gains made or loss avoided penalty besides disgorgement obtained from a civil court would be a more effective remedy than imprisonment under S. 24 of the SEBI Act (the courts are lenient in giving prison terms to economic offenders in any case). The SEBI should also seek asset freeze of bank accounts to catch insider trading funds from flying away and other ancillary reliefs like restitution, forfeiture of ill gotten gains when they cannot be returned to the rightful owner.

- **Case Laws with recent case of Rajat Gupta: An Overview**
- **Raj Rajaratnam/Galleon Group, Anil Kumar, and Rajat Gupta insider trading cases**

The **Raj Rajaratnam/Galleon Group, Anil Kumar, and Rajat Gupta insider trading cases** are parallel and related civil and criminal actions by the United States Securities and Exchange Commission and the United States Department of Justice against three friends and business partners: Galleon hedge fund founder-owner Raj Rajaratnam and former McKinsey & Company senior executives Anil Kumar and Rajat Gupta. In these proceedings, the men were confronted with insider trading charges: Rajaratnam was convicted, Kumar pleaded guilty and testified as key witness in the criminal trials of Rajaratnam and Gupta, and Gupta was convicted in Federal district court in Manhattan in June 2012.

Rajaratnam charges and trial

On October 16, 2009, defendants Raj Rajaratnam and Anil Kumar were arrested and indicted for insider trading and conspiracy. The charges stemmed from an investigation by the United States Attorney's Office into allegations that Rajaratnam conspired in insider trading of stock for several large companies. Rajaratnam was found guilty on all 14 charges and sentenced to 11 years in prison for profiting from tips he received from Robert Moffat, Anil Kumar, Rajiv Goel, and Roomy Khan. Chiesi was sentenced to 30 months in prison with 2 years of supervised release. During the discovery phase of the criminal trial, the USAO turned over to the defendants the contents of 18,150 wiretapped communications involving 550 different people, which were recorded over the course of sixteen months from ten telephones, including home, office and mobile lines belonging to the defendants. Kumar maintained a low profile outside McKinsey until an October 2009 arrest in conjunction with an ongoing and wide-ranging US governmental investigation into insider trading. Former mentor Rajat Gupta was later arrested by the FBI in a related case, prompting inquiries into McKinsey's senior leadership and business model.

As of December 2009, Kumar was no longer at the consultancy. In January 2010 he pleaded guilty to insider trading charges and was the government's star witness in March 2011 in *U.S. v Rajaratnam* against his billionaire friend and Galleon Group founder Raj Rajaratnam. In the sprawling case his involvement was unusual; according to a *Reuter's* blog, "He's the only informant who could be considered even more successful than Raj was, at least professionally if not in terms of raw cash. Raj had money, more money than he really knew what to do with, but Kumar had much more societal acceptance and prestige." He settled with the SEC in May 2010 for $2.8 million, the amount after gains he received from Rajaratnam through a Swiss bank account in a domestic worker's name. Gupta, Rajaratnam, and Kumar were all close friends and had founded the $1.3-billion private equity firm New Silk Route together, though Rajaratnam and Kumar withdrew before the firm began operation.

On October 26, 2011 the United States Attorney's Office filed charges against Rajat Gupta. He was arrested in New York City by the FBI and pleaded not guilty. He was released on $10 million bail (secured by his Connecticut house) on the same day. Gupta's lawyer wrote in an e-mail quoted in *Bloomberg*, "Any allegation that Rajat Gupta engaged in any unlawful conduct is totally baseless .... He did not trade in any securities, did not tip Mr. Rajaratnam so he could trade, and did not share in any profits as part of any quid pro quo." "The tips generated 'illicit profits and loss avoidance' of more than $23 million, the [SEC] alleged in [the] lawsuit. 'Rajat Gupta was entrusted by some of the premier institutions of American business to sit inside their boardrooms, among their executives and directors, and receive their confidential information so that he could give advice and counsel,' said Manhattan U.S. Attorney Preet Bharara, whose office is prosecuting the case."

Origins of the case

On Friday October 16, 2009, Raj Rajaratnam was arrested by the FBI and accused of conspiring with others in insider trading in several publicly traded companies. U.S. Attorney Preet Bharara put the total profits in the scheme at over $60 million, telling a news conference it was the largest hedge fund insider trading case in United States history. Jim Walden, an attorney for Mr. Rajaratnam, said his client is innocent and will fight the insider-trading charges.

Rajaratnam allegedly profited from information received from:

- Robert Moffat, an senior executive of IBM considered next in line to be CEO
- Kumar, a senior executive of McKinsey and close friend of Gupta (its former CEO) who was later also accused of passing information to Rajaratnam
- Rajiv Goel, a midlevel Intel Capital executive
- Roomy Khan previously convicted of wire fraud for providing inside information from her employer, Intel, to Rajaratnam.

It was reported that Rajaratnam, Goel and Kumar were all part of the class of 1983 from Wharton business school.

The Sri Lankan stock market fell sharply after his arrest on insider trading charges in October 2009. Sri Lanka's Securities and Exchange Commission is reviewing the active stock trading of Raj Rajaratnam with a view of identifying any insider trading. It said he also conspired to get confidential information on the $5 billion purchase by Warren Buffett's Berkshire Hathaway of Goldman preferred stock before the September 2008 announcement of that transaction. The Wall Street Journal reported in April that a former member of the board of directors of Goldman Sachs and former McKinsey & Company chief executive Rajat Gupta told Rajaratnam about Berkshire's investment before it became public. Gupta stood to profit as would-be chairman of Galleon International, a co-founder of New Silk Route with Rajaratnam, and as a friend of Rajaratnam. In March 2011 Gupta was charged in an administrative proceeding by the SEC. Gupta maintained his innocence, countersued, won dismissal of the administrative charge, and then was arrested on criminal charges.

Gupta charges and trial

On March 19, 2010, it was announced that Gupta had decided not to stand for re-election to the Goldman Sach's board of directors. At the time this was seen as a reaction to the insider trading implications; however, wiretaps released over a year later in *U.S. v Rajaratnam* of Anil Kumar speaking to Rajaratnam reveal an anticipated conflict-of-interest with a senior advisory role at Kohlberg Kravis Roberts. Gupta has since stepped down as senior advisor to KKR.

On April 15, 2010, the *Wall Street Journal* reported that federal prosecutors in the United States were investigating Gupta's involvement in providing insider information to Galleon hedge-fund founder Raj Rajaratnam during the financial crisis, in particular the $5 billion Berkshire Hathaway investment in Goldman Sachs at the height of the financial crisis in September, 2008. Coverage of the event noted that Anil Kumar — who, like Gupta, had graduated from IIT, was a longtime highly-regarded senior partner at McKinsey, and had also co-founded the ISB — had already pleaded guilty to charges in the same case. Gupta, Kumar, and Rajaratnam were all close friends and business partners.

When Goldman Sachs CEO Lloyd Blankfein asked Gupta about his insider trading rumors breaking in the press, Gupta replied, “I wouldn't have had anything to do with that."

On March 1, 2011, the SEC filed an administrative civil complaint against Gupta for insider trading. It is alleged that he illegally tipped Rajaratnam with insider information about Goldman Sachs and Procter & Gamble while serving served on the boards of both companies. Rajaratnam, it is alleged, "used the information from Gupta to illegally profit in hedge fund trades. ... The information on Goldman made Rajaratnam's funds $17 million richer. ... The Procter & Gamble data created illegal profits of more than $570,000 for Galleon funds managed by others," the SEC said. "After a [Goldman Sachs] board call ... Mr. Gupta is said to have hung up the phone and called Mr. Rajartnam 23 seconds later. The next morning, the SEC says, Galleon funds sold their Goldman holdings, avoiding losses of more than $3 million," *The New York Times* continued. Gupta "vigorously denied the SEC accusations." He is being represented by respected white-collar criminal attorney Gary Naftalis of Kramer Levin Naftalis & Frankel LLP in connection with the charges. Mr. Naftalis "strongly denied that [Gupta had] done anything wrong" in 2010 when Gupta's name was first mentioned relative to the case and said in March 2011 that the SEC charges were "totally baseless." Naftalis went on to say "that Gupta is not accused of receiving anything in exchange for information provided [and that] Gupta lost his entire investment in Galleon by fall 2008." The lost investment was specified to be "USD 10 million ... in the Galleon Buccaneers Voyager Fund."

Naftalis, , and the judge in the case Jed Rakoff, 68, are "longtime friend's, according to a report during the trial which also noted a certain jocularity between them, including a joke about relative reputations of different educational institutions, in open court.

Another important aspect of insider trading is *gain* -- Gupta's lawyer Naftalis said on March 1 that "Gupta is not accused of receiving anything in exchange for information." Yet a week later in *U.S. v Rajaratnam* it emerged that "Mr. Rajaratnam ... might pay Mr. Gupta with a large stake in the fund, and that Mr. Rajaratnam loaned Mr. Gupta money so he could increase his investment in a Galleon fund." It also emerged that Mr. Gupta was in talks to become chairman of Galleon International, and therefore also stood to profit. Wiretaps in *U.S. v Rajaratnam* were later played of Gupta asking Rajaratnam, "I want ... us to keep having the dialog as to ... how I can be helpful in Galleon International [and] Galleon Group."

After Rajaratnam's conviction and the revelations about to Gupta in the Rajaratnam trial, the difficulty of SEC's proving even the civil charges against Gupta was still deemed considerable by observers. Among other aspects, the May, 2011, *Bloomberg* report noted that, "remarkably, none of Gupta's alleged criminal tips to Rajaratnam appear to have been captured on the FBI's wiretaps." But the report also noted a March 2010 e-mail from Gupta to Ajit Rangnekar, dean of the Indian School of Business, with denials, assertions and, in the reporter's opinion, "obvious inaccuracies," leaving many questions on how the cases and story would yet unfold. In the immediate aftermath of the SEC's filing of charges on March 1, 2011, "spokesmen at American Airlines and Harman said they had no comment. Genpact, where Gupta is chairman, issued a statement saying he 'has made invaluable contributions to Genpact, and has always sought to hold Genpact to the highest standards of integrity and corporate governance.'" Gupta also served on the board of and Procter & Gamble (P&G), but stepped down immediately on March 1, 2011 "to prevent any distraction to the P&G board and our business," said a spokesman. On March 7, 2011 he resigned from the boards of AMR Corp, American Airlines, Harman International and ultimately Genpact Ltd.

On March 10, 2011, Gupta stepped down as chair of the International Chamber of Commerce "until a satisfactory resolution of the case." On March 15 he stepped down as chairman of the Public Health Foundation of India. On March 20 he resigned as chairman of the Indian School of Business, after some controversy at the school and in India. On March 29 he stepped down as advisor to the Gates foundation. By April 2011 he had resigned from every board chairmanship or membership.

In the high-profile insider trading case *U.S. v Rajaratnam* unfolding near the same time (March 2011), wiretaps were played of Gupta describing to Rajaratnam elements of the confidential meetings of the board of directors of Goldman Sachs, including its possible willingness to purchase commercial bank Wachovia or insurer AIG. On March 15, 2011 an FBI wiretap from July 28, 2008 was played in the *U.S. v Rajaratnam* trial between Rajat Gupta and Raj Rajaratnam in which the two men discuss Goldman Sachs, Anil Kumar, Galleon International and Kohlberg Kravis Roberts. The tapes caused concern for several reasons:

- **Confidentiality** Gupta revealed board-privileged material on Goldman Sachs to Rajaratnam, after a 34-year career respecting client confidentiality at McKinsey. This by itself, however, is unlikely to be sufficient to criminally charge Gupta, as it may not meet the standard for insider trading. It should also be noted that the call can simply be construed as one friend calling another for help in preparing for a meeting with Gary Cohn, Goldman's president. *("AIG was definitely in the discussion mix.")*
- **Habituality** Gupta's information to Rajaratnam was delivered very casually, as though it were not uncommon. A *Bloomberg* profile quotes a CEO saying the wiretaps "sounded to him just like Gupta consulting a client."
- **Gain** A key notion in insider trading is that of benefit to the tipper. This benefit does not have to be monetary; in the case of Galleon co-conspirator Robert Moffat of IBM, the gain was relational with Danielle Chiesi. Here the gain is clearly a chairman role in Rajaratnam-owned Galleon International and further investment opportunities with Rajaratnam, including New Silk Route and other Galleon funds. *("You've given me a position at Galleon International…that's good enough.")*
- **Complicity** Gupta, as head of McKinsey for a decade, was well aware of McKinsey's rules prohibiting outside consulting. Yet he was neither surprised nor upset at protégé and business partner Anil Kumar's illegal (by McKinsey rules) external dealings with Rajaratnam, particularly the offshore cash payments. It remains unclear whether Gupta was aware Rajaratnam was paying Kumar for inside information.
- **Legal maneuvering** Gupta's lawyer had released statements saying "There are no tapes or any other direct evidence of me tipping Mr Rajaratnam" and that "the business relationship between Mr Rajaratnam and I were strained." Yet the tapes reveal Gupta divulging confidential (if not material non public) information, and Gupta asking Rajaratnam for career advice.

- **Fragmentation** In another tape, Anil Kumar asks Rajaratnam, "It's now reached a point where it's physically and humanly impossible to do the things he's doing, right?" and the two wonder about Gupta's "fragmented" state. In another wiretap, Rajaratnam suggests to Kumar that Gupta "seemed tormented" at their last meeting. As the tapes were released McKinsey was holding its regular annual partners conference, and according to a spokeswoman was "monitoring the matter and taking it seriously as you would expect." [52] They later released a statement saying they were "appalled and deeply dismayed." The firm has come under heavy criticism for having its former long time senior partners and leaders (Gupta and Kumar) as well as a junior partner (Palecek) all involved in the insider trading scandal. On March 18, 2011 Gupta countersued the SEC (SDNY 11 Cv. 1900). The court filing read, "Mr. Gupta denies all allegations of wrongdoing and stands ready to mount a defence against each and every one of the Commission's charges. Yet under current Commission rules, Mr. Gupta would be deprived of a jury trial, the right to use the discovery procedures of the federal court to shape his defence and the protections of the federal rules of evidence, which were crafted to bar unreliable evidence." The countersuit said the SEC action "'unfairly and unconstitutionally' singles him out," as he is to date the only person not employed by a broker-dealer ever charged by the SEC in administrative proceedings. It is not known whether the provisions of Dodd-Frank (the law allowing for SEC administrative proceedings in this instance) may be applied retroactively to before the law's existence, as the SEC has claimed in charging Gupta.

On March 23, 2011 Goldman Sachs CEO Lloyd Blank fein testified that Gupta had in fact divulged board-privileged material to Rajaratnam, though the particular information was allegedly confidential and not material nonpublic (the legal standard for insider trading).

In July 2011, U.S. District Judge Rak off refused to throw out the countersuit against the SEC and in August, Gupta and the SEC agreed to drop their respective actions against each other. The judge had drawn attention to the fact that all 28 other SEC actions stemming from the Galleon case had been filed in federal court. As part of the August agreement, the SEC agreed to file any future charges against Gupta in federal court in New York where they would be assigned to Rak off. There was no comment on whether such charges would be filed. Just over three months after the SEC allegations of insider trading, Goldman Sachs shareholder James Mercer filed suit against Gupta "seeking to recover any 'short-swing' profits on Goldman's behalf."

In late September, 2011, *The Wall Street Journal* reported that federal prosecutors were "fully committed" to filing criminal charges and were "moving closer toward bringing" them. They had previously sparred over how, when, and whether to arrest or sue Gupta, in "a bitter dispute between federal prosecutors and securities regulators."

On October 26, 2011 the United States Attorney's Office filed charges against Gupta. He was arrested in New York City by the FBI and pleaded not guilty. He was released on $10 million bail (secured by his Connecticut house) on the same day. Gupta's lawyer wrote in an e-mail quoted in *Bloomberg*, "Any allegation that Rajat Gupta engaged in any unlawful conduct is totally baseless .... He did not trade in any securities, did not tip Mr. Rajaratnam so he could trade, and did not share in any profits as part of any quid pro quo." "The tips generated 'illicit profits and loss avoidance' of more than $23 million, the [SEC] alleged in [the] lawsuit.'Rajat Gupta was entrusted by some of the premier institutions of American business to sit inside their boardrooms, among their executives and directors, and receive their confidential information so that he could give advice and counsel,' said Manhattan U.S. Attorney Preet Bharara, whose office is prosecuting the case."

Former Federal prosecutor Douglas Burns, who in March had said he expected an SEC-Gupta consent agreement, also previewed a Gupta no-quid pro quo defense plan on *Bloomberg* the day of the arrest. Three days before Gupta's arrest, Rajaratnam was reported to have said that the prosecutors had wanted him to wear a wire and tape his conversations with Gupta. "It was Rajaratnam understands that were he to plead guilty and wear a wire, he might be offered a sentence of as little as five years. With good behavior, he could be out in 85 percent of that time," the report continued. Rajaratnam did not — and has not ever, at time of writing — cooperated with federal prosecutors. He has been sentenced to 11 years in prison.

The trial on six counts of securities fraud and one count of conspiracy will commence before Judge Rak off May 21, 2011. The case is U.S. v. Gupta, 11-cr-00907, U.S. District Court, Southern District of New York (Manhattan). The date represents a six-week delay granted the defense after the prosecution broadened the indictment, adding a new charge based on a March 12, 2007, conference call and also regarding Goldman information. Each of the fraud counts carries up to 20 years in prison and the conspiracy count up to five years. Gupta also faces a fine of as much as $5 million, prosecutors said. They also said that his "investments with Rajaratnam -- $10 million and an ownership stake in at least two funds -- gave him the motive to engage in insider trading", according to one news report. The parties also discussed another possible Rajaratnam "tipster" being investigated at Goldman. The second individual had no relation to the Gupta charges and the judge agreed with the prosecution to keep the witness statements on the individual under seal. David Loeb, a Goldman Sachs managing director, Henry King, a Goldman Sachs analyst, and Matthew Korenberg, a Goldman Sachs analyst, are being investigated by the government as tippers to hedge funds. The same day as US v. Gupta, the SEC sued Gupta again (this time not in an administrative proceeding) over civil claims related to the criminal charges in US v. Gupta.

In April, 2012, another charge relating to passing P&G information was added by the prosecution. Gupta's lawyers said that "newly added charges -- like the ones brought last year -- are not based on any direct evidence, but rely on supposed circumstantial evidence". More new charges based on new information may follow. Also in April, CNBC reported that the U.S. Attorney's office in Los Angeles was investigating an unnamed current Goldman employee for providing inside information about Apple and Intel to Rajaratnam. The defense has maintained that "the wrong person is on trial".

In early May, 2012, a pre-trial defense motion for access to SEC settlement-negotiation documents was denied by Judge Rak off. Also in early May, the prosecution made a motion to play in trial three FBI wiretaps of two Rajaratnam "conversations with his principal trader and another with Galleon's then portfolio manager" related to the Goldman Sachs information. As well, details of wiretap recordings and trading activity related to the charges were analyzed at length in the media, assessing the strengths and weaknesses of the prosecution's and defense's cases. Telephone records surfaced at Gupta's trial suggesting that he "let Rajaratnam listen in to a conference call among board members regarding an upcoming earnings announcement. At the call's end, Rajaratnam purchased 450K shares, making about $2M the next morning when Goldman announced an earnings beat." Gupta was found guilty of conspiracy and three counts of securities fraud on June 15, 2012. He was acquitted on two counts of securities fraud in federal court in New York. He now faces up to 20 years in prison on each of the fraud charges and five years on the conspiracy charge. Sentencing is set for Oct. 18.

World-renowned speaker Deepak Chopra and Mukesh Ambani, the ninth-richest man in the world [and] ... chairman of Reliance Industries", were among supporters of Gupta's registered on a *friendsofrajat.com* website prior to the trial. The site was established by retired McKinsey associate of Gupta's Atul Kanagat. This has come into play in the trial of Gupta for character witness purposes.

Relationships of Rajaratnam, Gupta and Kumar

Rajat Gupta and Anil Kumar were senior partners together at McKinsey & Company for over a decade, among the earliest and best-regarded Indian-Americans in management consulting. They became friends and enjoyed a mentor-protégé relationship early into Kumar's career as senior partner. The two men co-founded the Indian School of Business in 1997 and "were the face of McKinsey in India."

According to *The Financial Times,* "the two operated as a forceful double-act to secure business for McKinsey, win access in Washington and build a brotherhood of donors around the Hyderabad-based ISB and a handful of social initiatives." Gupta first met Raj Rajaratnam while fundraising with Kumar for the Indian School of Business in 1999. Rajaratnam and Kumar had attended Wharton business school together in the 1980s. Two years later Gupta and Rajaratnam served together on the board of directors of the American India Foundation.

In 1999 Rajaratnam filed a lawsuit against the Gupta-advised TeleSoft partners and its founder Arjun Gupta (no relation), a former McKinsey consultant himself Gupta, Rajaratnam, and Kumar were all involved to varying degrees in the creation of private-equity firms Taj Capital and New Silk Route. Gupta had written Rajaratnam's home address as his own in the fund formation papers.[84] Rajaratnam and Kumar were founding partners of the private-equity firms but left before they began operation. Kumar testified that he was "treated...poorly" by his friends in the formation of the firms. Gupta remained founding partner and chairman of New Silk Route, and Rajaratnam eventually invested $50 million in New Silk Route. While they were both senior partners, Gupta and Kumar "created a company called Mindspirit LLC in 2001 as a vehicle for their two families to make investments." Mindspirit consulted with Info group and its then-CEO Vinod Gupta (also no relation) in return for stock options; though an Infogroup SEC filing would later question the payment and the business relationship between the two companies. Vinod Gupta would also say that Mindspirit was "created by the wives of Rajat Gupta and Anil Kumar." Rajat Gupta and Anil Kumar's work at Mindspirit and the relationship with Genpact both broke McKinsey's own rules (in spirit, though perhaps not technically) on external for-profit involvements, according to McKinsey's head of communications. Former President Bill Clinton was also an investor in the Info group transaction; his daughter Chelsea previously worked under Gupta and Kumar at McKinsey. Clinton had also served as chairman of the American India Foundation with Gupta and Rajaratnam. During the dot-com bubble of the late 1990s, Gupta and Kumar had created a program to allow McKinsey to accept stock in lieu of consulting fees. Rajaratnam intended to make Gupta chairman of "Galleon International," an expansion of the Galleon Group. Rajaratnam considered paying Gupta "with a large stake in the fund."

Gupta was "a regular presence at Galleon's offices ... and showed up there periodically for lunch. Mr. Rajaratnam's secretary would order in Indian or Chinese food and the two men would sit in Mr. Rajaratnam's office and chat." Gupta visited Rajaratnam "biweekly" in September 2008 during the financial crisis. Rajaratnam and Kumar vacationed together in Kenya, Africa and Miami, Florida. Kumar was a regular visitor to Gupta's houses in Connecticut, Colorado, Manhattan and Florida. Gupta was "regularly invited" to Rajaratnam's house in Manhattan and for Galleon parties. Gupta and Rajaratnam were also connected through Goldman Sachs. From 2006 - 2010 Gupta served on the board of the bank, by which point Rajaratnam's Galleon Group "paid hundreds of millions of dollars a year to its Wall Street banks and in return regularly received market information that would not have been disclosed to most investors." Gupta and Rajaratnam also used their Goldman Sac relationships to market New Silk Route. Gupta and Kumar both personally invested in Rajaratnam's Galleon funds, though Gupta lost a $10 million investment in Galleon's Voyager fund. Rajaratnam also "loaned Mr Gupta money so he could increase his investment in a Galleon fund." Gupta knew that Rajaratnam was sending money to Kumar against McKinsey policies and possibly illegally. The three men were also not above gossip: Rajaratnam said Gupta "seemed tormented" while on the phone with Kumar, then turned around and called Kumar a "mini-Rajat" while on the phone with Gupta. Rajaratnam also told Kumar that "there had been a lot of innuendos" about Gupta and Lata Krishnan, with whom Gupta had co-founded the American India Foundation.

Other cases stemming from Rajaratnam original case

The president of Insight Research, a privately held investment research company, has been arrested and charged with insider trading as part of the US government's investigation into illegal trading by the Galleon Group hedge fund. Tai Nguyen surrendered to the Federal Bureau of Investigation's New York office on June 26, according to an FBI spokesman, and later pleaded guilty to one count of conspiracy to commit securities fraud.

Rakesh Aggarwal Vs SEBI[31]

Rakesh Agarwal, the Managing Director of ABS Industries Ltd. (ABS), was involved in negotiations with Bayer A.G (a company registered in Germany), regarding their intentions to takeover ABS. Being the Managing Director with such high portfolio it goes without saying that he has access to the price sensitive information. Rakesh Aggarwal in order to escape from the vigilant eyes of SEBI played a trick. He wanted to circumvent the provisions of law through tactful manner. Before the announcement of the merger is made public through announcement, he made a collusive agreement with his brother to take over the shares of ABS from the market. Thereafter he tendered the same shares through the open offer making a huge profit. These clandestine agreements could be traced by SEBI through their thread bare investigation. Bayer AG subsequently acquired ABS. Further he was also an insider as far as ABS is concerned.

The secretive agreement entered between Rakesh Aggarwal and brother in law to acquire the shares before the merger is carried out is a violation of section 3[32] and 4 of the Securities Exchange Board of India prohibition of Insider Trading Regulations, 1992**.** Rakesh Aggarwal vehemently denied the allegations leveled against him by the SEBI stating that he has acted in such a manner for the benefits of the company and he has no intention to have personal gains. He said that he wanted to acquire 51 percent shares of the company of ABS through Bayer and he wanted to plan to be executed in clinical precision. The SEBI directed Rakesh Agarwal to deposit Rs. 34, 00,000 with Investor Education & Protection Funds

[31] APPEAL NO.33 OF 2001

[32] Section 3 (1) of the regulation States that No insider shall either on his own behalf of any other person, deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive information. Section 3(11) of the Regulation states that the insider shall not communicate, counsel or procure directly or indirectly any unpublished price sensitive information who while in possession of such price sensitive information shall not deal in securities. Provided nothing contained above shall be applicable in the ordinary course of business (or profession or employment) or under any law.

of Stock Exchange, Mumbai and NSE (in equal proportion i.e. Rs. 17, 00,000 in each exchange) to compensate any investor which may make any claim subsequently.

- A case against Rakesh Aggarwal is made out under section 24 of the SEBI Act.
- Adjudication proceedings under section 15I read with section 15 G of the SEBI Act against Rakesh Aggarwal.

Rakesh Aggarwal made an appeal to Securities Appellate Tribunal, Mumbai. The Tribunal held that the part of the order of the SEBI directing Rakesh Agarwal to pay Rs. 34, 00,000 couldn't be sustained, on the grounds that Rakesh Agarwal did that in the interests of the company (ABS), as is mentioned in the facts above.

Samir. C. Arora vs. SEBI[33]

In the case of **Samir. C. Arora vs. SEBI**[34], Mr. Arora was prohibited by the SEBI in its order not to buy, sell or deal in securities, in any manner, directly or indirectly, for a period of five years. Also, if Mr. Arora desired to sell the securities held by him, he required a prior permission of SEBI. Mr. Arora in contested this order of SEBI in the Securities Appellate Tribunal. SAT set aside the order of SEBI on grounds of insufficient evidence to prove the charges of insider trading and professional misconduct against Mr. Arora.

These cases testify the fact that the SEBI lacks the thorough investigative mechanism and a vigilant approach due to which the culprits are able to escape from the clutches of law. In most of the cases, SEBI failed to adduce evidence and corroborate its stance before the court. Unlike the balance of probabilities that is required in proving a civil liability, a case involving criminal liability requires the allegations to be proved beyond reasonable doubts. Therefore there should be thread bare investigation and all the loopholes if any should be properly plugged in.

HINDUSTAN LIVER LIMITED VS. SEBI[35]

Hindustan Liver Limited happens to be the subsidiary of the Unilever Limited. The merger of the HLL with BBILL was on the cards. The controversy involved purchase of 8 lakhs shares of Brooke Bond Lipton India Limited two weeks prior to the public announcement of the merger of the two companies. SEBI suspecting foul play conducted investigation. After a comprehensive investigation spanning 15 months SEBI issued a show cause notice to the Chairman, all Executive Directors, the Company Secretary and the then Chairman of HLL. Later in March 1998 SEBI passed an order charging HLL with insider trading.

SEBI felt that there is something wrong in the entire scheme of things. SEBI sensed that HLL had access to some un published and price sensitive information and therefore issued show cause notice showing that there was prima facie evidence that the company was indulging in insider trading through the use of 'Unpublished price sensitive information' prior to its merger with Brooke Bond India Lipton Limited. It was indeed a danger bell which was rang by SEBI asking them to desist from indulging in such nefarious activities. It was only after about 15 months of detailed analysis that SEBI issued a notice to HLL asking why it shouldn't be slapped with an insider trading charge.

The Hindustan Liver Limited faced the music from all quarters as it was found to divulge price sensitive information. Hindustan Liver Limited was about entering into a merger agreement with the Brooke Bond Upton India Limited. Before the merger was actually effected, Hindustan Liver Limited purchased the shares of the Brooke Bond Upton India Limited. It goes without saying that HLL had knowledge and information about the impact of the merger on the value of the shares of the company. In March 1998, SEBI passed an exhaustive order which sent shockwaves down the spine in the corporate sector. The SEBI analyzed the facts in the touchstone of the SEBI (Prohibition of Insider Trading) Regulations, 1992. HLL had access to price sensitive and unpublished information as a result of which found guilty of insider trading. SEBI directed HLL to pay UTI Rs 3.4 crore in compensation, and also initiated criminal proceedings against the five common directors of HLL and BBLIL: S.M. Datta, K.V. Dadiseth, R. Gopalakrishnan, A. Lahiri, and M.K. Sharma, who were on the core team which discussed the merger.

The Securities and Exchange Board of India's (SEBI) decision to prosecute country's second largest corporate, Hindustan Lever, and its five senior directors has brought into sharp focus the grey areas of insider trading laws as well as the absence of any corporate transparency and governance among Indian companies. There is a divergence between the corporate lawyers and the former justices regarding the definition of the insider. The counsel for SEBI interpreted the term insider in such a manner so that they would be in a position to prove the fact there is insider trading in the instant case involving Hindustan Liver Limited.

[33] (2002) 38 SCL 422
[34] (2002) 38 SCL 422
[35] (1998) 3 Comp LJ 473

The term insider is still considered to be a grey area in our country. The brokers had a different story to tell in the context of the case. According to the brokers, nobody made any profits through the insider trading. It was a negotiated deal at a price above the market price. The deal helped the Unilever to retain 51 percent stake in the HLL after the merger with the Brooke Bond Lipton India. The SEBI is of the firm opinion that HLL acted as an insider. However, Former Chief Justice of India P.N Bhagwati had a different view point altogether. He was of the opinion that the SEBI should take some technical assistance from the Securities Exchange Commission of the United States so as to streamline our insider trading regulations.

With the SEBI, HLL, former justices (hired by the multinational), and corporate lawyers interpreting `insider trading' to suit their requirements, it has confused the common investors and shareholders who have been witnessing insider trading almost on a daily basis on the Indian bourses. In March 1998, SEBI announced criminal prosecution of five HLL directors for insider trading and asked it to pay Rs. 3.04 crores to UTI as compensation.

One of the recent cases that can illustrate this trend is allegation against Reliance Petroleum, that it has indulge in insider trading activity on large scale, which is evident from the fluctuation in its share price in the past fifty two weeks, the share has fluctuated in a wide range of between sixty seven rupees and two hundred ninety five rupees, as per information available with the stock exchange. But according to company sources 'the sale of Reliance Petroleum shares was conducted by transactions through the Stock Exchanges and has helped to further broad base the shareholding pattern of Reliance Petroleum'.

It will be interesting to find out whether SEBI, will be able to prosecute the insider's involved in the case or they would be let off for the want of evidence. The insiders often escape stating that their action is actuated by a good motive which is often not the case but the law becomes soft on them which is really the plightful side of the story. It is high time that we should make an introspection regarding the fact that the regulations should serve the purpose rather than being paper tigers. Thread bare investigation should be done in a systematic manner. As a result the Enforcement of restrictions upon insider trading runs the risk of either being ineffective or being a witch hunt.

Conclusion

The Securities Exchange Board of a country has a central objective i.e., protecting the interests of the investors and regulating the business in stock markets and other securities markets. The Indian Exchange Commission, i.e., SEBI seeks to look after and secure the same. The Primary function of SEBI is to ensure that the interest of the innocent investors' are protected since they repose complete faith and trust on SEBI as an able and efficient regulator. The prevention of an insider trading is a is just an extension of its primary function of safeguarding the interest of the investors'. The principle of business standards and ethics demands that some discipline and decorum should be followed in the administration of the company as well as the stock market. From the point of view of the internal administration of the company, it is really an uphill task to keep an eagle eye on the use of sensitive information for personal gains since the people at the helm of the affairs such as directors who owe a fiduciary duty to keep the company in proper shape are the one who give preference to their vested interest over the interest of the company.

In the modern era of Liberalization, Privatization and Globalization, there is heavy inflow of Foreign Direct investment where we find that there is participation from foreign companies and all. The disclosure of price sensitive information before the publication really casts aspersion on the role of the SEBI as an efficient regulator. India has to strengthen its enforcement of recently amended insider trading act, so as to prove to both the domestic and foreign investor that they are investing in fair and transparent securities market, where strict compliance of the prohibition is ensured by the enforcement agencies.

It is seen that the insider trading is done under disguised names and entities so that they can maintain a shareholding over and above the trigger limit of SEBI without making it public. Such kind of ill founded and mischievous design should be dealt with iron hands and precautionary measures should be undertaken. Prevention is always better than cure. Enforcement of insider trading can be made more efficient in India, if the time limit for disclosure of holding to the company by any person having a holding of more than five percent (four days) and further the disclosure by the company to the stock exchange of information received about the above transaction (five days), should be reduced to one day in total. Also like other developed countries the above stated disclosure should be made to both exchanges and the regulator, instead of exchange alone.

Further, there should be a provision of civil penalties, like in US, where the penalties are based on the profit made or loss avoided, also SEC let's off the offender, if he pays without admitting to offence, but merely publishes the settlement, which acts as a deterrent to the society and prevents cases from being locked up in the court. Additionally, the maximum penalty limit of five lakh106 rupees should be increased, as the profit reaped by the insider runs into a huge amount.

The importance of policing insider trading has assumed international significance as overseas regulators attempt to boost the confidence of domestic investors and attract the international investment community. Reports from the international press confirm a proliferation of law-making and regulatory actions within just the last several months in countries across the globe aimed at curbing insider trading. For example, in 1998 alone: Hong Kong regulators unveiled new measures to combat insider trading, including the introduction of new electronic surveillance capability[36]. Malaysia amended to its securities laws, for the first time giving investors a private right of action against insider traders[37]. In its efforts to curb insider trading, the Securities and Exchange Board of India enacted regulations requiring that corporate deals be reported to stock exchanges within 15 minutes of finalizing[38]. Vietnam announced a decree establishing its first public securities market, which includes prohibitions on insider trading[39]. The government of Egypt announced that it is working on a comprehensive reform of its regulation of the Cairo Stock Exchange, to bring it into line with world standards[40]. The Netherlands Securities Board announced that it is launching an investigation into whether the Amsterdam Exchanges have sufficient systems in place to detect and investigate insider trading. These developments herald a new era of universal recognition that insider trading, in the words of the SEC's Chairman Levitt, "has utterly no place in any fair-minded law-abiding economy." [41]

Finally, preventing insider trading is not about a set of rules or filling alleged loopholes. It is about a determination to go after illicit trades and the power to punish offenders. Until SEBI shows it is serious about checking insider trading, the activity will continue to thrive unchecked. For that the regulatory authority has to ensure that the SEBI Regulations on Insider trading is a separate code by itself. Preferably, it must be made into a separate Act as a part of general law relating to frauds, as is the case in the US. This will ensure that SEBI does not have to draw concepts and principles from the UK and US laws to strengthen its case. At the same time it must also avoid the impression that there is ambiguity or weakness in the Indian Insider Trading Regulations.

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