"Insider trading" laws in India – Status before and after the enactment of Indian Companies Act, 2013

Author:-

Siladitya Dasgupta [1]
Deepsikha Bhowal [2]

ABSTRACT

The new Indian Companies Act of 2013 has introduced several new concepts, and one of which is that of the Insider Trading. This article is an attempt to analyse the nuances of this concept. This article traces back the source by which this concept has been broached in India.

The article contains a detailed analysis on the followings:

i) **Introduction** – A detailed analysis of the concept of Insider Trading. It also traces the background of this concept from an international as well as an Indian perspective.

ii) **Why it is necessary to regulate insider trading**– Under this section of the article the necessity to regulate insider tradinghas been analysed.

iii) **Indian Constitution viz-a-viz Unlawful insider trading**– Relationship between the Insider Trading laws along with the provisions of the Indian Constitution have been analysed in this section of the article.

iv) **Insider Trading Laws in India - before and after enactment of Indian 2013 Act** –Laws upon insider trading in India have been categorized into two typesunder this section of the article. Here the laws before the Companies Act, 2013 and after the Companies Act, 2013 have been analysed.

> "*Unfortunately, from what I can see from my vantage point as an Attorney, illegal insider trading is rampant and may even be on the rise. Insider*

[1] Name of Institution: ***Jogesh Chandra Choudhuri Law College (J.C.C. Law College)***, ***University of Calcutta,*** Current occupation:Working, at Ernst & Young LLP,Position: Legal Analyst

[2] Name of Institution:***Jogesh Chandra Choudhuri Law College (J.C.C. Law College)***, ***University of Calcutta,*** Current occupation: Student, Current Year: 4th year

trading should eminently be a deterrable crime"- Preet Bharara, U.S. Attorney for the Southern District of New York.

Part-I - Introduction:

What is insider trading? Insider trading can be defined as, trade of one company's securities which is based on non-public information of that company.

This malpractice of insider trading is prevalent throughout the world including UK., USA, Germany and Norway etc. India is no exception to this. USA was the first country which enacted a legislation to regulate the insider trading. This bold decision taken by the US Congress had surprised many around the world, because in certain parts of the world access to confidential / inside information and its use for personal gain were regarded as the benefits of having reached a high stage in life. In contradiction to this sentiment, the restrictions on insider trading were mocked by many. However, over past few years most of the countries recognized the need of restrictions upon insider trading.

India was not late in acknowledging the need of such restrictions upon insider trading. The country recognized the detrimental impact of insider trading which can inflict upon the rights of other shareholders and investors who are unaware of any price sensitive privileged information. Till the enactment of Companies Act, 2013 ("**2013 Act**") the laws enforced to prevent insider trading were Securities Exchange Board of India Act, 1992 ("**SEBI Act**") and the SEBI (Prohibition of Insider Trading) Regulations, 1992 ("**SEBI Regulations**"). But these regulations failed to prevent this unfair trade practice in the India. The newly enacted 2013 Act prescribes strong punishment for practicing insider trading. This newly enacted law is much more stringent in comparison to previous laws. This paper is an attempt to analyse the previous and current status of insider trading laws in India, with a comparative study of insider trading laws prevalent in USA and UK.

Part-II-Why it is necessary to regulate insider trading:

Generally insider trading can be categorized into two types, i.e. **Lawful insider trading** and ii) **Unlawful insider trading**. Lawful insider trading means, insider trading **not** based upon any price sensitive information which is not available in public domain. On the other hand unlawful insider trading means, trade of a company's securities or stocks which is based upon any price sensitive information and the general public is not aware of such confidential information. There is no restriction upon the first type of insider trading as mentioned above i.e. 'Lawful insider trading' which is contrary to 'Unlawful insider trading'. To bring equity and fair trade practices regulation of such unlawful insider trading is necessary. In a recent survey it has been shown that, illegal insider trading plays a huge role in raising the cost of capital for securities issuers, which eventually results into decrease in overall growth of economy[3]. In other words it can be said that unlawful insider trading discourages investment in markets therefore its negative impact hampers the development of the capital market. Unlawful insider trading also violates the "**equal access to resources for all**" principle. After detailed analysis of illegal insider trading it can be said that, it is a clear violation of "**fair competition model**", where only few individuals have the access to price sensitive information which they use in performing unlawful insider trading and the other participants of the market are unable to get such information. Due to this trend "**Concentration of owners**" in the market rises and the market becomes less liquid. In many surveys it has been quite evident that the countries - where the laws regulating the unlawful insider trading – have much lower equity cost than the countries where such prohibitory laws are not enacted and the capital markets of such countries (where the anti-insider trading laws are enacted) are broader i.e. liquid[4].

The above mentioned negative impacts of the unlawful insider trading clearly indicate why the regulation of this illegal trade practice has become a necessity.

Part-III- Indian Constitution viz-a-viz Unlawful insider trading:

Article 19 (1) (g) of the Indian Constitution provides fundamental right to all citizens *to practice any profession, or to carry on any occupation, trade or business*. But this fundamental right has reasonable restrictions under Article 19(6). By this reasonable restriction the state has the authority to make any law for prevention of such unfair trade practices.

In the case of **M/S Eskay K N I T (India) Ltd. And Ors. Vs. Union Of India And Ors.[5]**, the High Court of Rajasthan also held that the unlawful insider trade practices are fraudulent and the state has authority to make laws for prevention of such fraudulent trade practices under clause 6 of Article 19.

Though the scope under the Indian constitution regarding the unlawful insider trading is quite narrow but still the constitutional provisions as sated above highly discourages this unfair trade practice.

[3] The World Price of Insider Trading (2002) –Bhattacharya and Daouk
[4] The World Price of Insider Trading (2002) –Bhattacharya and Daouk
[5] D.B.Civil Writ Petition No.4582/2010

Part-IV-Insider Trading Laws in India - before and after enactment of Indian 2013 Act:

Laws upon insider trading in India can be categorized into two types:

I) Before enactment of 2013 Act;
II) After enactment of 2013 Act;

I) Insider trading laws before enactment of 2013 Act:

Till the enactment of 2013 Act the laws relating to insider trading were controlled by the SEBI Act and the SEBI Regulations under the supervision of the Securities and Exchange Board of India ("**Board**"). Under Chapter-II of the SEBI Regulations it has been provided that – no insider[6] has the authority to deal in securities of a listed company when he has any unpublished price sensitive information with him, neither he can communicate such information with any other person[7].

Section 3A of the SEBI Regulations also provide that, no company has the authority to deal in the securities of another company when such former company has any price sensitive information with it.

Under this SEBI Regulation, the power has been given to the Board to make necessary inquiries and inspection with suspected persons[8].

Inspite of these provisions many analysts and former regulators opined that, India needs much more stringent laws to combat this unfair trade practice. According to Mr. Shriram Subramanian[9],

"….*there is no fear of regulation in market participants. In case the insider traders are caught after long trials, the punishments have been very light in comparison to their potential profits....*"

The SEBI Act provides imprisonment upto ten years and penaly upto 25 crore rupees or 3 times of the profit, whichever is higher[10]. But in reality the mximum penalty imposed by the SEBI is INR 60 lakhs only[11]. And the main set back of these SEBI Regulations is that they are only applicable on insider trade in listed companies.

[6] Insider means- any person connected, directly or indirectly with the company and is reasonably expected to have price sensitive information which is not available in public domain in respect of securities of such company.
[7] Rule 3 of SEBI Regulations.
[8] Rules 4A, 5, 6, 7 of the SEBI Regulations.
[9] Founder of InGovern, a corporate governance research firm
[10] Section 15 and 24 of the SEBI Act.
[11] matter of Jayaprakash Associates, http://www.sebi.gov.in/cms/sebi_data/attachdocs/1325832569186.pdf

II) Insider trading laws after enactment of Indian Companies Act, 2013 ("2013 Act"):

Finally in 2013 the new Indian Companies Act came into force and for the first time in India the Companies Act provided laws regulating the unfair insider trading. In this context it is very important to keep in mind that the previous Companies Act, 1956 was completely silent on unlawful insider trading. The new 2013 Act brings a whole new regime via Section 193.

Section 195 of the 2013 Act provides a whole new definition of insider trading. This definition of insider trading is very much specific, which says that,

Insider trading includes an act of:

- Subscribing;
- Buying;
- Selling;
- Dealing or agreeing to subscribe;
- Buy, sell or deal,

in any securities by any director or key official of a company either as a principle or agent based upon such price sensitive information in respect of securities of such company.

Also an act of communicating (directly / indirectly) any such price sensitive information to any other person will be regarded as insider trading[12].

The new Companies Act provides heavy penalty in case of insider trade in listed and unlisted companies. If any person violates the provisions of section 195, then he shall be punishable with imprisonment for a term which can be extended up to 5 years or with fine which shall not be less than 5 lakh rupees and which can be extended upto 25 crore rupees or 3 times of the profit amount made out of such insider trading, whichever is higher or he might get punishment with both. Finally the much desired stringent penal provisions for insider traders came into force in India by the enactment of the Companies Act, 2013. Unlike the SEBI Regulations regarding insider traders which were only applicable for listed companies, the new provisions apply on unlisted companies as well. These new provisions on insider trading are a huge and much needed step taken for the protection of the shareholder's interest.

Part-V- Comparative study of laws on insider trading between India, U.K., and U.S.A:

Comparison between India and UK laws:

[12] Section 195(1)(b) of the Companies Act, 2013

In UK, the Criminal Justice Act, 1993 ("CJA") and the Financial Services and Markets Act, 2000 ("FSMA") provide statutory regulations for insider trading in UK. But none of the Act gives any proper definition of insider trading. The CJA prescribes the insider trading as a criminal offence. The FSMA authorises the Financial Services Authority of UK to punish any offender involved in misuse of information, misleading practices etc.

Both the UK and Indian laws have almost similar definition of price sensitive information.

In UK civil and criminal liabilities are dealt under separate status but in India both such liabilities are dealt under the same statue.

Previously the ambit of insider trading laws in India was limited to listed companies only but after the 2013 Act the ambit includes both listed and unlisted companies same as UK.

Under the 2013 Act the maximum limit of imprisonment in India is up to 5 years whereas in UK the maximum limit is of 7 years.

Comparison between India and USA laws:

USA has been the first country to address strongest laws to prevent insider trade. The Securities Exchange Act, 193 (SAE) has been the first legislation to prevent insider trade. Other statutes in USA to prevent insider trading are, Insider Trading Sanction Act, 1984 ("ITSA"), the Insider Trading and Securities Fraud Enforcement Act, 1988 ("ITSFEA").

The insider trading laws in USA is an integral part of their general law relating to fraud unlike Indian insider trading laws, which is a separate regime in India.

The penalties in USA for insider trading are equivalent to penalties provided under Indian insider trade laws. In both the countries the penalty may be as high as 3 times of the profit gained by insider trading. The US laws on insider trading are much more stringent than Indian insider trading laws.

The US law provides that the profits obtained by insider trading within a period of 6 months may be recovered by the company or by any shareholder on its behalf. But no such provision is there under the Indian regulations.

Part-VI- Conclusion:

After the enactment of 2013 Act in India the ambit of insider trading laws have become wider. Inclusion of unlisted companies is a remarkable step, which can protect the rights of the share holders in general.

On this ground my suggestions to prevent insider trading are as follows:

- Creation of an ‘Insider Trading Policy’ where blackout dates shall be specified along with definition of ‘insider’, ‘insider information’ in simple language.
- Companies should have internal watchdog who will monitor trades of stocks of such company.
- Companies should appoint third parties like-accounting firms etc. which will verify holdings of insiders.
- The government should create a separate department which will only deal with complaints regarding insider trading and such information providers will be awarded if they give any such information regarding any insider trading or potential insider trading.
- All private companies shall come under the jurisdiction of Right to Information Act, 2005.