



**UKCA<sup>®</sup>**  
AND PARTNERS  
ADVOCATES & SOLICITORS

# Insider Trading Laws in India

June 12, 2021  
Presented by:

**Pradyumna Yadav**  
**Edited By: Ravi Kumar, Principal Consultant**

## PHONE

+91 11 410 35 343  
+91 11 410 35 342

## EMAIL

contact@ukca.in  
www.ukca.in

## ADDRESS

E-2, Kailash Colony,  
New Delhi – 110048

# INSIDER TRADING AND BASIS FOR ITS PROHIBITION

Insider Trading refers to when an insider on his own behalf or on behalf of other person deals in securities of body corporate listed on any stock exchanges on the basis of unpublished price sensitive information [UPSI] and includes communication except under ordinary course of business or procurement of UPSI for the purpose of dealing in securities.

Insider refers to a connected person [one owes fiduciary duty, for example Directors, Promoters, Legal Counsels, etc] and person who have possession [Lawful/Unlawful is immaterial] of UPSI.

Reasons for prohibition on Insider Trading is mainly because

- Information asymmetry is a bane for the securities market participants, those person who take undue advantage of information asymmetry needs to be punished.
- It goes against levelling of playing field in the securities market.
- If there is rampant insider trading, it deters the investor confidence in the market. SEBI is entrusted with the duty to empower and protect investor interest.
- It is needed for ensuring fairness and transparency in the dealing of securities market.

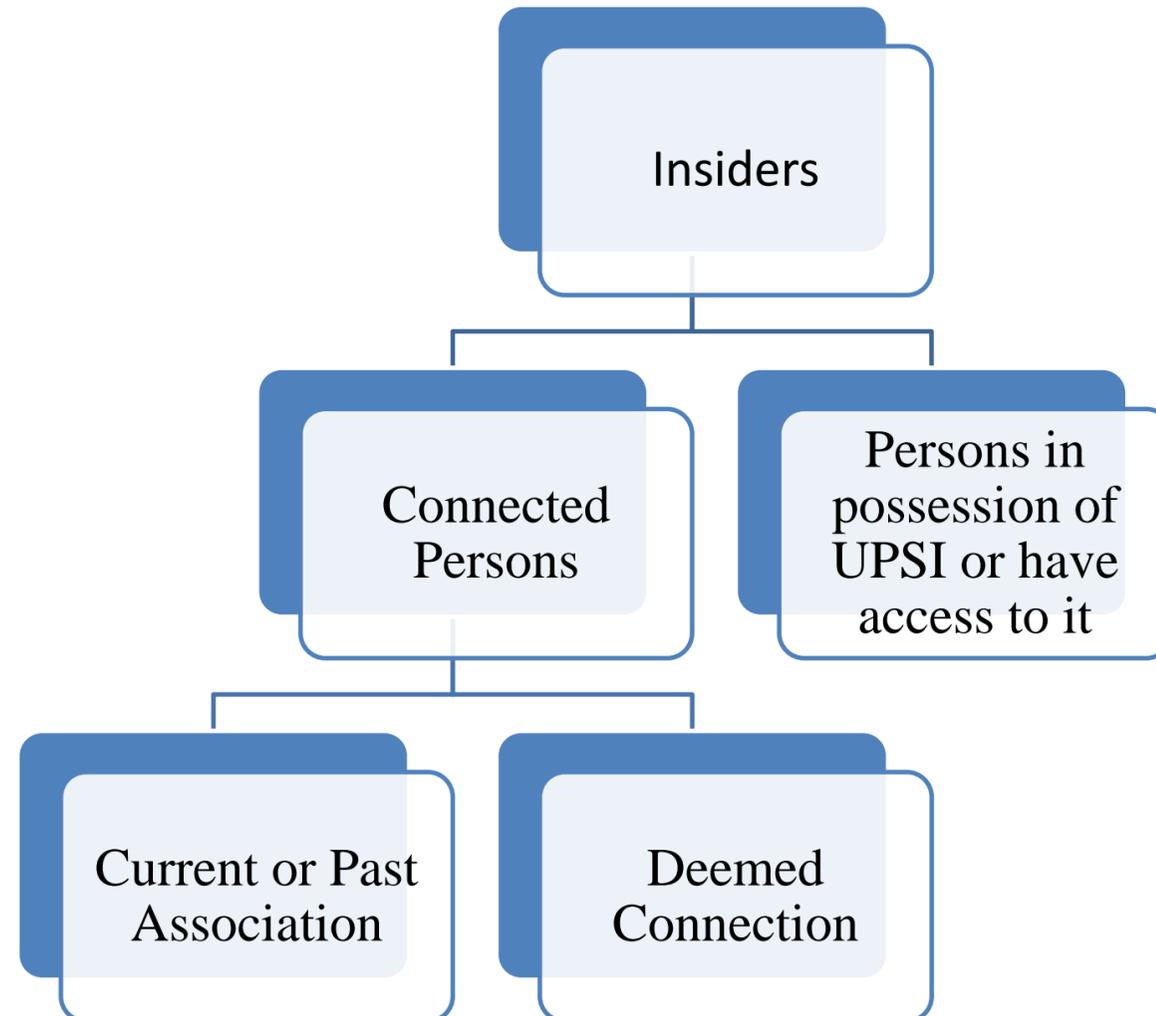
SEBI (Prohibition on Insider Trading) Regulation, 2015 is the primary legislation dealing with the prohibition on insider trading. SEBI is the regulatory body dealing with prohibition for Insider Trading.

# ESSENTIALS OF INSIDER TRADING

There are two essentials of Insider Trading, i.e., an insider and unpublished price sensitive information.

## Who are Insiders?

‘Insiders’ are typically a wide range of individuals who trade in securities listed on stock markets based on inside information unknown to the investing public.



Originally, only directors and senior-management were considered insiders, as they have direct sources of information relating to a company and would be in a position to assess the materiality of such information. Such persons are also known as ‘primary insiders’. They obtain UPSI by virtue of their position, employment, or relationship with the company, which makes them ‘connected’ or ‘associated’ with a company. It may also include persons having direct professional or business relationships with the company, such as auditors, lawyers, and bankers.

The terms "insider" and "connected persons" in the 2015 Regulations cover primary insiders, as well as persons who receive information from primary insiders (i.e., "secondary insiders"). For instance, the spouse of a director becomes a secondary insider if he or she receives UPSI from the director (who is a primary insider).

The term "secondary" signifies that such insiders fall outside a direct "connection" or "access" relationship with a company, and therefore, any information received from them would have a primary insider as the source of the information. Any person who receives UPSI becomes an insider, and is subject to same restrictions on communication of UPSI and prohibition on trading as any other insider.

"Possession insiders" form another category of insiders. They are considered insiders simply based on their possession of UPSI. This includes persons who temporarily possess UPSI, such as consultants and advisers engaged for specific time-bound assignments. It also includes accidental insiders who stumble into possession of UPSI, without having access to UPSI or receiving a tip. For instance, a person who overhears private conversations or stumbles upon confidential documents would also be a possession insider.

## **What is Unpublished Price Sensitive Information?**

Unpublished Price Sensitive information is such an information which is:

- Generally **not** available
- Information has likely to have material effect of disrupting the prices of company's listed securities value.

## **Generally Available Information**

Generally available information means information that is accessible to the public on a non-discriminatory basis. In other words, it refers to information that is widely distributed to the public without exclusion, such that it can be accessed by any person without breach of any law. For example, in a situation where the CEO of a company collapses in the reception of a doctor's clinic. Since the CEO collapsed in a public place, information that the CEO has collapsed is not UPSI. Whereas the CEO when collapses in a private board meeting, such information would be UPSI. Therefore, the directors or employees of the company that witness the CEO collapse in the board meeting would be prohibited from trading in securities of the company.

## **Material Price Effect**

Materiality is a mixed question of law and fact which requires a delicate assessment of the inferences that a reasonable shareholder would draw from a given set of facts and the significance of those inferences to him. Thus an ordinary information that is likely to have no effect, or an immaterial or insignificant effect, on the share prices of a company. This requires a real-time judgement of the information available to the insider at the time of trading. Financial Results, Dividends, Change in Capital Structure, Mergers, demergers, acquisitions, delisting, disposals, expansion of business, change in KMP are some information which are material information which is possibility of having disruptive price effects upon disclosure to the public.

# DEFENCES TO INSIDER TRADING

Defences to insider trading is broadly of two types:

- Defences based on information symmetry
- Intent-based defences

Regulation 4(1) of SEBI (Prohibition on Insider Trading) Regulation prescribes six forms of defences to insider trading. Defences are as follows:-

- **Inter-se Insider trades:**

This defence relies upon two elements, first the trade in question was an off-market trade between insiders based on a conscious and informed trading decision by both parties. Second, both the insiders possessed identical UPSI without breaching the restrictions on communication of UPSI.

- **Chinese Walls:**

Chinese Walls are defined as self-enforced informational barriers consisting of systematic, as opposed to ad hoc, procedural and structural arrangements designed to stem the flow of information in organisations. The use of "Chinese Walls" is a defence to insider trading by non-individual insiders, i.e. companies and other business organisations. Such entities usually comprise several different departments; where one department receives UPSI in the course of its business, and another department is engaged in securities trading, conflicts of interest arise. Information possessed by any person in such organisation, or possessed by a department, may be attributed to the entire organisation. As such, the organisation can be said to be an insider who is prohibited from trading in securities of the company to which the UPSI relates. They can be also used as a means to prove that UPSI possessed by certain individuals in an organisation, could not have come into the hands of persons who made the trading decision on behalf of such organisation; as it effectively "walls in" UPSI, demonstrating that the trade was not motivated by UPSI.

- **Trading Plans:**

These plans are to be formulated and presented to the compliance officer in advance of trades planned for a subsequent date, by which time any UPSI possessed by the applicant would ordinarily become generally available. The compliance officer must approve and disclose such plans to the public. Thereafter, trades may be carried out in accordance with the plan. Any trade from such plans would not amount to insider trading as the information has already been disclosed to the public at large.

- **Block Deals:**

The SEBI has prescribed guidelines for execution of large size trades through a single transaction. In order to facilitate execution of such large trades, stock exchanges are permitted to provide a separate trading window. Trades executed on this separate trading window are termed as "block deals", This defence is not required to comply with the reporting requirements imposed on the inter-se insider off-market trades as block window mechanism already has separate reporting requirements.

- **Transaction made pursuant to statutory or regulatory obligation**

Defence to insider trading, whereby an insider may show that the transaction in question was carried out pursuant to a statutory or regulatory obligation to carry out a bona fide transaction.

- **Excise of Options**

An insider may show that the transaction in question was undertaken pursuant to the exercise of stock options, in respect of which the exercise price was predetermined in compliance with applicable regulations. This defence points out that predetermined exercise prices and vesting periods for stock options would negate informational advantages possessed by insiders.

## ENFORCEMENT BY SEBI

SEBI can use both criminal and civil remedies as means of enforcement remedy for those who have purported to be involved in insider trading. The principle of double jeopardy enshrined in Article 20(2). Constitution of India prevents the SEBI from prosecuting and punishing a person from the same offence more than once. However, the SEBI may initiate both criminal and civil action against a person in relation to the same subject-matter without giving rise to double jeopardy.

**In Gangotri Textiles Ltd, re**, the SEBI whole-time member found that the principle of double jeopardy applies only in case of criminal proceedings, and not to adjudication proceedings under Chapter VI-A of SEBI Act, 1992 (which are neither criminal nor quasi-criminal)

Under Sections 11 and 11-B, SEBI Act, the SEBI has the power to issue orders and directions in the interests of investors or securities market, either pending investigation or inquiry or on completion thereof, including the power to impound and retain the proceeds or securities in respect of any transaction under investigation and the power to requisition call data records from telecom service providers. These powers are meant to be exercised for preventive or remedial purposes in the interest of investors or the securities markets.

Section 11-B, SEBI Act confers upon the SEBI the power to order disgorgement. It refers to the act of giving up something (such as profits illegally obtained) on demand or by legal compulsion. Under common law, it is a monetary equitable remedy involving the repayment of ill-gotten gains that is imposed on wrongdoers by courts to prevent unjust enrichment. Disgorgement is a common term in developed markets across the world, but it is relatively new to the securities market in India.

# CHALLENGES & PROBLEMS IN INDIA REGIME - OUR OBSERVATIONS

- Good legislative but lacks enforcement
- Size of Indian securities market is huge, this equates to greater difficulty
- 
- Lack of adequate tech support
- Rise of High-Frequency Trading
- Whatsapp and Insider Trading-Privacy Concerns

**THANK YOU**