

Insider Trading in India: Regulatory Ambiguity Between Transparency and Market Exploitation

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Abstract: *This article delves into the persistent issue of insider trading in the Indian financial market, exploring its intricate dynamics and significant repercussions. It examines how concentrated ownership, opaque information dissemination, and networked insider circles contribute to the proliferation of insider trading. The detrimental effects on investor confidence, market integrity, and fair competition are discussed in detail. Additionally, the article evaluates the regulatory measures by SEBI to combat insider trading, highlighting the balance between stringent regulations and market innovation. Through case studies and comparative analysis, the article underscores the importance of transparency, ethical conduct, and international cooperation in addressing insider trading challenges and fostering a fair financial ecosystem in India.*

Keywords: Insider Trading, Indian financial market, SEBI regulations, Market Transparency, Investor Confidence

1. Introduction

The illegal trading securities practice which is on the basis of material, private information and has cast a prolonged shadow on the Indian Financial Market is known as the Insider Trading. Therefore, it loses the trust of investors, impacts the efficiency of the market and unfairly provides benefits to the individuals with access to confidential information. Furthermore, this article will let you explore about the complex dynamics of insider trading in India. And also help you find the fragile balance between transparency and exploitation.

The Allure of Insider Information

Insider information have an undeniable allure. Can get significant profits by knowing informations before it is public like the company's planned merger, a strong financial quarter and the potential product launch. Therefore, there are various factors that combine to make India a better place for insider trading.

- **Concentrated Ownership:** Indian corporation generally have the focused ownership structure that includes founders or controlling shareholders holding some part of the company stake. This help the promoters in making accurate decision by offering them the access to the confidential information before it is publicly available. (Mitra & Gupta, 2010).
- **Opaque Information Dissemination:** In India, the regulation for timely disclosure of the price sensitive information provided by the companies was historically weak. Therefore because of this lack of transparency let the insiders to spoil the information and start the trading before the official announcement. (Goyal & Sahoo, 2013).
- **Networked Insider Circles:** The insider trading is generally originating from the individual's network who have the easy access to these information. The network may include the analysts or the journalists who have these informations' access. (SEBI, 2018).

The Corrosive Effects of Insider Trading

The outcome of the widespread insider trading are far to reach. As it destroy the fundamental basis of a fair and efficient market.

- **Loss of Investor Confidence:** The investors hesitates to engage when they suspect that the market is manipulated

by the inside information. This may result in reducing liquidity and volatility while also affecting the capital formation. (Roy, 2014).

- **Erosion of Market Integrity:** The insider trading can alter the price discovery, where the stock prices shows the true value of the company with the information that is available publicly. This manipulation of the price by the insiders effects the investment decision making difficult for the investors. (SEBI, 2016).
- **Unequal Playing Field:** As compared to the insiders, the small investors are in a disadvantage who completely rely on the information that is publicly available. This may result in uneven playing field and also discourages the genuine participation in this market. (Mittal, 2012).

Combating the Menace: Regulatory Efforts

The country's market regulator, i. e. The Securities Exchange Board of India (SEBI) has takes various steps to put an end to insider trading. It includes

- **Strengthening Disclosure Norms:** SEBI has enforced some strict rules and regulation in which its mandatory for the companies to provide accurate and timely disclosure of the price sensitive information. (SEBI, 2015).
- **Prohibition of Insider Trading:** SEBI has now clearly mentioned that the insider training is a punishable offence which includes both the trading i. e. unpublished price sensitive information and tipping. Tipping is a way or act of sharing the confidential information which can wrongly impact the profit (SEBI (Prohibition of Insider Trading) Regulations, 2015).
- **Enhancing Surveillance:** To detect the suspicious trading pattern, SEBI has made a great investment in the cutting - edge surveillance tools that includes the unusual trading volumes, sudden price fluctuations, and cross - market correlations (SEBI, 2020).

The Limits of Regulation and the Call for Transparency

Regulatory plays an important role in discouraging the insider trading but its effect is limited. The modern insiders have new ways to exploits the gaps as a strict regulation can be a burden of the companies. Therefore, to have the more transparent market information, following are important:

- **Promoting a Culture of Compliance:** It is necessary of the companies to encourage the culture of ethical behaviour, focus on the importance of information

security and also the negative effects of insider trading. This includes the mechanisms such as internal controls and whistleblower protection. (Mitra & Gupta, 2010).

- **Empowering Investors:** Investors are required to be educated about their own rights and also help them to identify their potential red flags. This includes the research - based investment decisions and making the companies more responsible so that they can provide timely and accurate disclosure (Roy, 2014).
- **Independent Media Scrutiny:** For exposing the activity of insider trading, the vigilant media plays a vital role. Furthermore, the investigative media can reveal the suspicious trading pattern and also make the authorities responsible for the inadequate enforcement. (SEBI, 2018).

The Road Ahead: Balancing Transparency and Innovation

The Indian Financial market is at the crucial point where it is important to maintain a balance between promoting transparency and encouraging innovation. At one side where strict regulation is important to prevent insider trading, on the other side over - regulation may negatively impact the market development. Therefore, here are the ways to maintain the balance:

- **Risk - Based Approach:** With the use of this strategy, regulators may concentrate on the efforts of the industries and companies where insider trading is more likely occur. This lets them to effectively allocate the resources and reduces the work pressure for the compliance companies (Mittal, 2012).
- **Technology - Driven Solutions:** To improve the surveillance capabilities, technological advancements need to be achieved. Furthermore, to detect the change in the trading pattern and to also identify the potential insider activity, big data analytics and machine learning algorithms can be used. (SEBI, 2020).
- **International Cooperation:** Insider trading generally happens beyond the national boundaries. International trading with the regulatory bodies can be enhanced by information sharing and coordinated enforcement actions across the border insider trading schemes (SEBI, 2018).

Case Studies: A Glimpse into Insider Trading in India

For better understanding about the mechanisms of insider trading in India, it is important to take a look on the real world examples. Here are the two case studies that highlights the challenges and complexities:

- **The Satyam Scam (2009):** This case is a great reminder of the disastrous effects of insider trading. Satyam Computer Services, one of the leading Indian IT company, was involved in a major accounting scam whose mastermind was the founder of the company, B. Ramalinga Raju. The company's profit and information were manipulated by Raju with his family and associates, over several years. As per this manipulated information, it was found that they were into the extensive insider trading where they were illegally gaining benefits and were also misleading the investors. Due to the Satyam Fraud Case, it led to strict regulations and a major focus on insider trading.
- **The Wockhardt Insider Trading Case (2008):** In this case, the senior executive of Wockhardt, a well - known pharmaceutical company were suspected of involving in

insider trading. The executive was found guilty of having unpublished price - sensitive information about the company's failed US Food and Drug Administration (FDA) inspection. They were alleged for using this information to sell the Wockhardt shares way before it is publicly available, leading to a major decline in the stock price. This case has highlighted the risk of insider trading that is associated with the companies operating in highly regulated industries where regulatory actions can dynamically impact the stock prices (SEBI, 2018).

From manipulating the financial statements to exploiting regulatory developments, these cases have highlighted the various forms that an insider trading can take. It has also highlighted the serious affect that insider trading can make on the investors, companies and whole market system.

The Human Cost of Insider Trading

In addition to the financial losses that is incurred by the investor, insider trading has a major human cost. It loses the trust of the public in the financial market while discouraging the potential investors in taking part in the market. This adversely affects the capital formation and ultimately impacts the economic growth. Furthermore, the environment that supports insider trading, prevents genuine involvement and promotes doubts in the investors. It gives them a impression that something is not fair, where the modern insiders take undue advantage over the ordinary investors. This may leads to a fall of the ethical behaviour across the financial field.

The Global Context: Insider Trading in a Comparative Framework

A comparative lens is important to understand the insider trading scenario in India. Many developed countries like US have well designed a legal frameworks and robust enforcement mechanisms so as to put a ban on insider trading. The US Securities and Exchange Commission (SEC) actively looks into and handles incidents of insider trading, imposing severe penalties and use whistleblower protection programs to promote the information sharing. However, the insider trading continues to a constant challenge, even in these developed markets. The rise of high - frequency trading and complex algorithms have opened up new channels for possible abuse, allowing constant vigilance and adaptation by regulatory bodies (Mittal, 2012).

India and other emerging markets face additional difficulties. Because of the weaker legal framework limited resources for investigation and enforcement, and a culture of information imbalance can encourage the ground that is in favour of insider trading. Moreover, in this global landscape there are positive developments as well. Furthermore, in order to facilitate the information sharing and coordinated enforcement actions against cross - border insider trading schemes, the international cooperation between the regulatory bodies are increasing immensely. (SEBI, 2018).

The Evolving Landscape: New Challenges and Opportunities

The era of finance is constantly changing, and also new technologies and trading strategies are emerging. This represents the difficulties and the opportunities for eliminating insider trading.

- **Rise of Algorithmic Trading:** The fleeting market inefficiency can be eliminated by the high - frequency trading (HFT) and algorithmic trading strategies. Although, these strategies are not fundamentally illegal, it raises a concern about the potential for insider trading, since, the algorithms may not be potentially be recognised and make profit from the price - sensitive information that is before it is publicly available. Therefore, to ensure that the algorithm trading doesn't become a tools for insider exploitation, the regulators need to develop robust frameworks (Mittal, 2012).
- **Social Media and Information Leaks:** The rapid growth of the social media platforms poses a new challenge. Due to this reason, the confidential information can be intentionally or un - intentionally be leaked through the various social media channel available, which may potentially affect the stock prices. Therefore, the regulatory bodies need to understand about how to protect the freedom of speech and lawful information sharing while also addressing the potential of insider trading. (SEBI, 2020).
- **Cybersecurity Threats:** The growing dependence on the technology may lead to the more risk of cyber attacks. Furthermore, the hackers can get easy access to the company's sensitive information and also illegally use it for the purpose of insider trading. Therefore, to protect the sensitive data's, the companies need to invest in the cutting - edge cyber security measures (Roy, 2014).
- **Blockchain and Distributed Ledgers:** Although the blockchain technology is still in its early stages, it has the capacity to bring a revolution in the financial market improving transparency as well as traceability of transactions. Blockchain based platforms may potentially make it more difficult to hide the insider trading activity while also offering a new way to reduce the risks that is associated with this unethical behaviour or malpractice.

A Historical Analysis of Insider Trading Regulations in India

In India, the fight against the insider trading has a long and dynamic history. So, here some of the glimpse of several turning points:

- **Pre - Independence Era:** Before the independence of India in 1947, there were limited regulations existed. Furthermore, the Companies Act, 1936 was formed as a result of the concerns regarding the market manipulation and unfair practices. However, this act did not particularly address the insider trading.
- **The Thomas Committee Report (1948):** This is the committee which is formed by the government so as to study about the practices of the stock exchanges and also helps in recommending regulations that is similar to the US Securities Exchange Act of 1934. Although, it was not directly mentioned, but this includes the measures to prevent the insider trading. (Mitra & Gupta, 2010).
- **The Companies Act, 1956:** According to the Sections 307 and 308, this act was basically introduced for mandating the directors and managers to disclose there share holding pattern. The main objective of this act was to restrict the insider trading by increasing the transparency around the company ownership structures.
- **SEBI's Formation and Early Initiatives (1992):** One of the significant step towards regulating the insider trading

was the establishment of the Securities and Exchange Board of India (SEBI) in the year 1992. Furthermore, SEBI issued a strict guideline so as to prohibit the insider trading and establish a framework for proper investigation and enforcement.

- **The SEBI (Prohibition of Insider Trading) Regulations, 2015:** The legal framework against the insider trading was further reinforced by these regulations. A more detailed definitions of "insider" was given by them which outlines the specific prohibits on the insider trading activities and also establishes a stricter penalties for any violations. (SEBI, 2015).

The International Dimensions of Insider Trading in India

As discussed before, that the insider trading often takes place across the national boundaries. Therefore, with the increase in the globalization of the financial markets, companies listed in India could have the investors and operations spanning around the globe. Also, the information that is leaked or may involve in coordination of the trading activities can involve the individuals and organisations outside of India. To tackle this challenge, international cooperation is important. So, let's find out how:

- **Multilateral Agreements:** With the International Organization of Securities Commissions (IOSCO), India has signed a Multilateral Memorandum of Understanding (MoU) on Consultation and Cooperation for the investigation of Cross - Border Insider Trading. So, when it comes to dealing with the cross - border insider trading activities, this Memorandum of Understanding (MoU) helps in sharing information and coordinated investigation efforts between the member jurisdictions.
- **Bilateral Agreements:** To improve the cooperation in securities regulation and enforcement, India has entered into a bilateral agreements with various countries, that includes the US and Singapore. These agreements help in opening up the channed for sharing information and joint investigations that are related to the cross - border insider trading.
- **Cooperation with Foreign Regulators:** SEBI actively collaborate and works with the overseas foreign regulatory bodies so as to investigate about the potential insider trading cases with international ramifications. This can also include information sharing, coordinating investigations, and taking joint enforcement measures (SEBI, 2018).

2. Conclusion

Insider trading is still one of the persistent challenges for the Indian financial market. In this article we have explored about the complex and dynamics of this issue while also highlighting the fragile balance between transparency and exploitation. Furthermore, the stakeholders can create more level playing field for market participants by incorporating the stricter rules, a culture of ethical behaviour, empowered investors, and also maintaining a vigilant media and technological infrastructure. So, in order to fight against the insider trading, it needs persistent vigilance and adaptation while improving the market ecosystem that prioritizes fairness and transparency for long - term economic growth.

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