Insider Trading: Indian Perspective

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The buying or selling of a security by someone who has access to material, nonpublic information about the security.

Insider trading can be illegal or legal depending on when the insider makes the trade: it is illegal when the material information is still nonpublic--trading while having special knowledge is unfair to other investors who don't have access to such knowledge. Illegal insider trading therefore includes tipping others when you have any sort of nonpublic information. Directors are not the only ones who have the potential to be convicted of insider trading. People such as brokers and even family members can be guilty.

Insider trading is legal once the material information has been made public, at which time the insider has no direct advantage over other investors.

When insiders, e.g. key employees or executives who have access to the strategic information about the company, use the same for trading in the company's stocks or securities, it is called insider trading and is highly discouraged by the Securities and Exchange Board of India to promote fair trading in the market for the benefit of the common investor.

Insider trading is an unfair practice, wherein the other stock holders are at a great disadvantage due to lack of important insider non-public information. However, in certain cases if the information has been made public, in a way that all concerned investors have access to it, that will not be a case of illegal 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.

Now we will refer to some cases of Insider Trading in India and world wide.

Former Goldman Sachs Indian-American board member Rajat Gupta, convicted of insider trading has been fined $13.9 million to settle related civil charges of feeding inside information to his friend, a billionaire hedge fund boss, Raj Rajaratnam.

The Securities and Exchange Commission announced the fine on Wednesday against Gupta, who was also permanently barred from serving as an officer or director of any public company. Gupta, a former chief of global consulting firm McKinsey & Co., was one of the biggest catches for the federal government in its five-year crackdown on insider trading that has brought about 70 criminal convictions.

Gupta was sentenced in October to two years in prison for passing confidential information gained from his position as a Goldman director to Raj Rajaratnam, founder of the Galleon group of 14 hedge funds. Gupta, who also had been a director of consumer products giant Procter & Gamble, was also ordered to pay a $5 million criminal fine.

Prosecutors said that Rajaratnam, who is serving an 11-year prison sentence, illegally reaped as much as $75 million through his trades, including about $11 million from the information provided by Gupta. The case revolving around Rajaratnam and the Galleon funds has been called the biggest insider trading prosecution in US history. Rajaratnam was fined $10 million in his criminal case and ordered to forfeit $53.8 million. He also paid a record $92.8 million civil penalty levied by the SEC.

Gupta's attorneys noted at his trial that he earned no profits from the scheme. Prosecutors accused Gupta of "above-the-law arrogance" in passing inside tips to Rajaratnam between March 2007 and January 2009. The advance information concerned a $5 billion investment by billionaire investor Warren Buffett's Berkshire Hathaway Inc. in Goldman and Goldman's financial results for the second and fourth quarters of 2008.

"The sanctions imposed today send a clear message to board members who are entrusted with protecting the confidences of the companies they serve," George Canellos, co-director of the SEC's enforcement division, said in a
Gupta's conviction marked a spectacular fall from grace for the Harvard-educated businessman, who was born in Kolkata, India. More than 400 letters were written on his behalf to the federal judge hearing his case, including documents signed by Microsoft co-founder Bill Gates and former UN Secretary-General Kofi Annan.

**Reliance Petro investments violated insider trading norms in the shares of erstwhile IPCL.**

The Securities and Exchange Board of India (Sebi) has fined Reliance Industries group entity Reliance Petroinvestments (RPIL) Rs 11 crore for violating insider trading norms in the shares of erstwhile IPCL before its merger with RIL.

"It may be concluded that by virtue of RPIL having control over IPCL, it was reasonably expected to have access to unpublished price sensitive information of IPCL. RPIL being the promoter having control over the company holding 46 per cent shares of IPCL is inherently expected to have access to price sensitive information. The company being in such a position it is unacceptable that it was not aware of such major/important decisions of the company IPCL," the Sebi order said.

Share price of IPCL on March 5, 2007, declined by 8.13 per cent on the BSE when the Sensex declined by 3.79 per cent. However, in a divergence from the index, the scrip witnessed substantial price gain on March 8, 2007, and March 9, 2007, subsequent to the announcement of amalgamation of IPCL with Reliance Industries.

The findings of the investigation led to the allegation that RPIL was in the possession of unpublished price sensitive information while trading in the scrip of IPCL prior to announcement of declaration of interim dividend and amalgamation of IPCL with Reliance Industries which resulted in violation of regulation 3 of SEBI (Prohibition of Insider Trading) Regulations, 1992.

**Worth Movies to See on Insider Trading:** Friends do once see the Following Movies (Sequence Wise) on Insider Trading and Investment Banking and whole Financial Markets how it actually works by taking time from your busy Schedule.

1. Wall Street (1989 Movie)
2. Wall Street: Money Never Sleeps (2010 Movie)
3. Too Big To Fail (2011 Television Movie)
4. Inside Job (2010 Documentary Movie)

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If the person who is aware of the material (undisclosed) information buys/sells the shares in the name of spouse or children, will it still be considered insider trading? And great article! :)

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Thanks Tanuj, sanket and Vipin.....!! Point noted Sanket....

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nice article

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So nicely drafted article.

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