

Insider Trading: Regulation & Global Comparison

Introduction

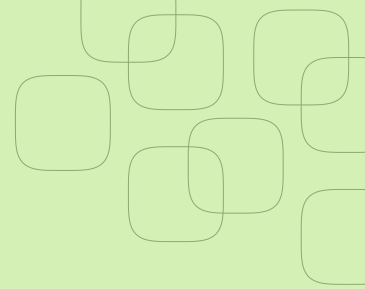
Insider trading, the act of leveraging unpublished price-sensitive information ("UPSI") for financial gain in the securities market has long been a contentious issue in corporate governance and financial law. Defined broadly, it encompasses trading conducted by individuals privy to non-public information, often resulting in significant unfair advantages. Such activities undermine market fairness and erode investor confidence, central pillars of robust financial systems.

The significance of regulating insider trading transcends legal compliance; it is deeply tied to fostering ethical practices and maintaining market integrity. Markets thrive on transparency and trust, yet insider trading introduces an asymmetry of information that disproportionately benefits insiders over regular investors. This erosion of trust can disrupt market operations, leading to broader economic repercussions.

This article seeks to explore the intricate web of insider trading laws. Furthermore, it undertakes a comparative analysis of insider trading regulations across jurisdictions, including India, the United States, and the European Union, to highlight evolving global standards and practices. By examining these aspects, the article aims to provide a comprehensive understanding of insider trading and its regulatory frameworks.

The Role of SEBI and the 1992 Framework:

SEBI was established in 1992 with the mandate to regulate the securities market and prevent malpractices such as insider trading. SEBI's intervention marked the beginning of a more structured approach to insider trading regulation. The insider trading provisions were incorporated into the SEBI Act, 1992, and the SEBI (Prohibition of Insider Trading) Regulations, 1992, which laid down the rules for the disclosure of price-sensitive information and prohibited trading based on such information.



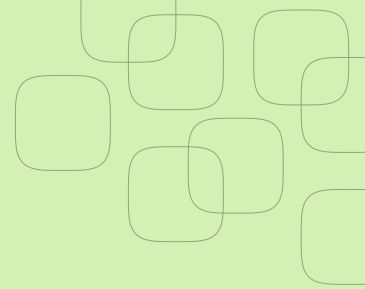
Modern Developments and Regulatory Enhancements:

Since then, the SEBI regulations have evolved to address new challenges in the financial markets, incorporating global best practices and ensuring greater transparency. Notably, the SEBI (Prohibition of Insider Trading) Regulations, 2015, provided a more robust framework to curb insider trading activities, with stricter penalties, enhanced enforcement mechanisms, and a clearer definition of “unpublished price-sensitive information” (UPSI). These regulations also empowered SEBI to take swift action against violators, ensuring that insider trading remains a punishable offence. Through the years, the Indian regulatory framework has progressively strengthened, focusing on transparency, fairness, and market integrity. SEBI continues to play a central role in monitoring and enforcing insider trading laws, ensuring that market participants adhere to ethical practices and protecting investors from unfair advantages.

Understanding Insider Trading

Insider trading involves the use of material, non-public information (UPSI) to trade securities, granting an unfair advantage to those privy to such information. SEBI’s (Prohibition of Insider Trading) Regulations, 2015 define an insider as someone connected to a company or in possession of UPSI, including directors, employees, or close associates. This practice undermines market fairness and investor trust by creating an uneven playing field.

The regulation of insider trading in India falls under the purview of the Securities and Exchange Board of India (SEBI), a statutory body established in 1992 to oversee and regulate the securities market. SEBI's role is to ensure transparency, protect investors, and uphold the principles of fairness in the market. Over the years, SEBI has implemented several regulations, including the SEBI (Prohibition of Insider Trading) Regulations, 2015, to address the complexities of insider trading and align with international standards. These regulations have been pivotal in curbing the misuse of unpublished price-sensitive information (UPSI) and ensuring that all market participants operate on an equitable footing.

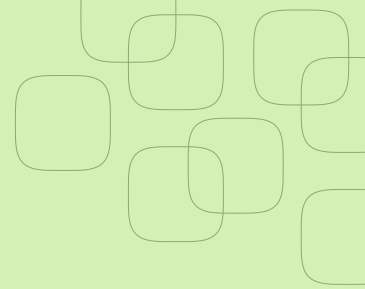


The SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations) are designed to prevent trading on the basis of non-public information that could influence the prices of securities. The regulations define "Unpublished Price Sensitive Information" (UPSI) as any non-public information related to a company or its securities that, if disclosed, could materially affect the security prices. Insider trading regulations prohibit individuals who have access to UPSI—referred to as insiders—from trading on or sharing such information, except for legitimate purposes or as required by law.

Regulation 2(1)(n) of the PIT Regulations specifies that UPSI includes any company- or securities-related information that is not publicly available but would affect the price of securities if it were disclosed. This broad definition encompasses various types of sensitive information until it becomes publicly available. "Generally available information" is defined under Regulation 2(1)(e) as information that is accessible to the public on a non-discriminatory basis. Regulation 2(1)(g) defines an "insider" as anyone, including connected persons, who has access to UPSI, clarifying that any individual possessing or having access to UPSI is considered an insider, regardless of how they obtained the information.

Regulation 3(1) prohibits insiders from disclosing UPSI unless it is for a legitimate purpose or in compliance with a legal obligation. Regulation 4(1) further prohibits insiders from trading in securities while in possession of UPSI. Once an individual is identified as having access to UPSI, they are prohibited from trading based on this information. Proving possession of UPSI is sufficient to establish a violation of Regulation 4(1), with no separate proof of the specific details of possession required.

Section 12A of the SEBI Act, 1992, as amended in 2002, explicitly prohibits insider trading. Clause (d) restricts any involvement in insider trading, including assisting or aiding such activities, while Clause (e) bans trading in securities when in possession of material or non-public information or communicating such information in violation of the Act or its regulations.



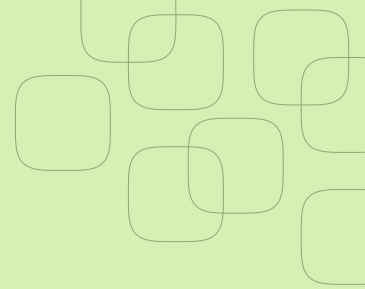
The PIT Regulations, 2015 replaced the earlier SEBI (Prohibition of Insider Trading) Regulations, 1992, making them the governing regulations under Section 12A(e). A violation of the PIT Regulations automatically leads to a violation of Section 12A(d) and (e).

Insider trading is categorized into legal and illegal practices. Legal insider trading occurs when trades comply with the regulations, such as when trades are conducted through pre-approved trading plans or permissible off-market transfers. Illegal insider trading involves trading securities while in possession of UPSI or sharing UPSI with third parties ("tippees") who use it for financial gain, which is subject to severe penalties under the SEBI Act.

Key regulations further elaborate on insider trading prohibitions:

- **Regulation 3 (Prohibition on Insider Trading):** Insiders are prohibited from trading securities while in possession of UPSI and from sharing UPSI with others unless required in the ordinary course of business or by law.
- **Regulation 4 (Trading When in Possession of UPSI):** This regulation prohibits insiders from trading securities while they have access to confidential information that could affect the price of those securities. The prohibition applies regardless of the insider's intent to benefit personally.
- **Regulation 7 (Disclosure of Trading):** Insiders, including directors and key management personnel, must disclose their trading activities to the company and stock exchanges when transactions exceed specified thresholds. These disclosures must be made within a set time frame to ensure transparency.
- **Regulation 9 (Pre-clearance of Trades):** Insiders are required to obtain pre-clearance for trades exceeding a specified value, which is determined by the company's internal policies. This ensures compliance with the company's code of conduct and prevents trading based on UPSI.

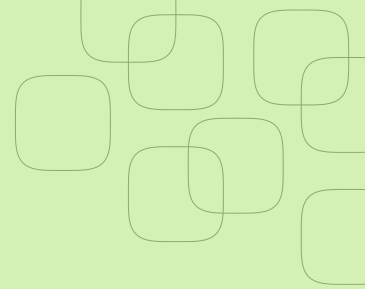
SEBI enforces strict penalties for insider trading under Section 15G of the SEBI Act, 1992, including fines from ₹10 lakh to ₹25 crore or three times the profit made, whichever is higher.



Offenders may also face up to 10 years in prison. SEBI can bar violators from the securities market and offers settlement options. Despite enforcement challenges, SEBI continues to enhance regulatory strategies to ensure market integrity and transparency.

Comparative Analysis: Insider Trading Laws and Enforcement

Insider trading laws differ significantly across jurisdictions, particularly in their definitions, enforcement mechanisms, and penalties. In India, the SEBI (Prohibition of Insider Trading) Regulations, 2015, defines insiders broadly to include individuals with access to unpublished price-sensitive information (UPSI), including immediate relatives. By contrast, the U.S. employs distinct theories, such as the "classical theory" and "misappropriation theory", which focus on the fiduciary duty breached by insiders. The U.K., governed by the Financial Services and Markets Act, 2000, criminalizes insider trading under stringent terms, often relying on distinct definitions for "price-sensitive information" and "connected persons". While Indian laws address both criminal and civil liabilities under a unified framework, the U.K. employs separate legislation for each, and the U.S. focuses heavily on punitive measures to deter violations. Enforcement mechanisms also vary. The U.S. Securities and Exchange Commission (SEC) employs advanced surveillance technologies and has the authority to wiretap communications, as evidenced in high-profile cases like Rajat Gupta. Similarly, the U.K.'s Financial Conduct Authority (FCA) imposes significant fines and prison terms, with tools to curb market manipulation. SEBI, while proactive in issuing penalties, faces challenges in evidence gathering due to limited resources and technological tools. Although bilateral agreements like Mutual Legal Assistance Treaties help India address cross-border insider trading, the absence of extraterritorial enforcement capabilities remains a limitation. These differences highlight the strengths of SEC and FCA mechanisms, offering valuable insights for SEBI to enhance its regulatory framework and international cooperation.



Judgement

The USA was the first country to establish laws regulating securities with the Securities Act of 1933, following the 1929 stock market crash. This was followed by the Securities Exchange Act of 1934, which laid the foundation for regulations on insider trading and securities fraud. In 1961, the USA became the first to enact a law banning insider trading. The landmark case SEC vs. Texas Gulf Sulphur Company in 1966 established the principle that anyone with inside information must either make it public or refrain from trading to prevent unfair advantage. The case of United States vs. Newman was pivotal in making insider trading illegal.

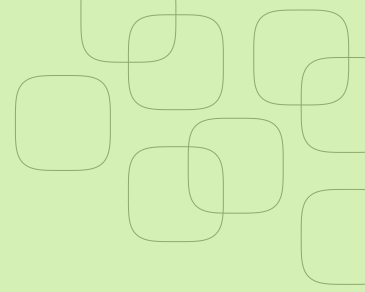
In India, the case of Hindustan Lever Limited (HIL) vs. SEBI was one of the earliest instances of SEBI taking action against insider trading. In this case, HIL bought shares from the Unit Trust of India and later a merger was announced. SEBI found this to be insider trading, and HIL's appeal was rejected, leading to an amendment in regulations and the introduction of the term "Unpublished Price Sensitive Information" in India. Another important case was Reliance Industries Limited (RIL) vs. SEBI, where RIL's purchase of a large stake in L&T was investigated for insider trading. SEBI initially found RIL guilty, but the Appellate Tribunal overturned the decision, stating that there was no evidence of insider information being passed.

Challenges in Proving Insider Trading

SEBI's robust regulatory framework plays a crucial role in deterring insider trading and safeguarding market integrity. Proving insider trading requires establishing both knowledge and intent, which can often be challenging for regulators. Circumstantial evidence is frequently relied upon, making it difficult to conclusively demonstrate that trades were executed based on UPSI. Additionally, grey areas such as accidental disclosures or ambiguous communications complicate investigations.



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By imposing stringent penalties, restricting market access for violators, and offering settlement options, SEBI reinforces accountability and fairness in India's securities market. Its continued vigilance ensures investor confidence and a level playing field for all market participants.

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