

# Insider Trading in India: Evolution of Law, Regulatory Framework, and Emerging Challenges

**Mr. Osho Gupta**

Student, Law, Amity Law School Noida

## **Abstract:**

This paper offers a thorough examination of insider trading in India, looking at its history, legal system, and current difficulties. The practice of trading securities based on significant non-public information, or insider trading, has long been a controversial topic in global financial markets. The Securities and Exchange Board of India (SEBI) and other regulations were the results of India's efforts to control insider trading, which started in the late 1970s. Highlighting significant committee reports and legislative turning points, the paper charts this historical evolution. The current regulatory environment is then examined, with particular attention paid to the SEBI (Prohibition of Insider Trading) Regulations and their most recent revisions.

The article discusses significant cases that have influenced the regulatory landscape while analyzing SEBI's strategy for detecting and prosecuting insider trading. Insider trading still presents problems for regulators and market integrity despite tremendous advancements. These challenges are examined in the paper, along with the need for investor protection, the argument over criminal liability, and evidentiary barriers. Additionally, it offers a balanced viewpoint on this complicated matter by presenting arguments for and against the legalization of insider trading. The article ends by outlining possible ways to improve India's insider trading laws, stressing the value of corporate governance, education, international collaboration, and the legal system. The article seeks to add to the continuing discussion on how to effectively regulate insider trading in India's developing financial markets by offering this thorough overview.

**Keywords:** Insider Trading, SEBI, Securities Regulation, Corporate Governance, Financial Markets, Investor Protection, Regulatory Compliance, Indian Stock Market, Unpublished Price Sensitive Information, Market Integrity.

## **Introduction:**

India is not an exception to the long-standing controversy surrounding insider trading in global financial markets. This practice has the potential to compromise investor confidence and market integrity since it involves trading in a company's securities based on material non-public information. The need for strong regulation to stop and punish insider trading has increased along with the development of India's capital markets. This article attempts to give a thorough analysis of insider trading in India by following its development over time, looking at the current legal system, and analyzing the difficulties that regulators

and market players still face. By exploring these facets, we can better comprehend the intricacies of insider trading and the continuous attempts to uphold equitable and effective.

### **The Evolution of the Insider Trading:**

As legislators and market watchers realized the possible harm insider trading could cause, the process to regulate it in India started in the late 1970s. A number of committee reports and legislative turning points that have influenced the current regulatory environment can be used to trace the development of insider trading regulation in India.

### **Sachar Committee:**

The Sachar Committee report from 1979 was the first to formally acknowledge insider trading as a bad practice. Two important recommendations were made by the highly influential Expert Committee on Companies and Monopolies and Restrictive Trade Practices Act (MRTP). First, it demanded that anyone with price-sensitive information fully disclose all transactions. Second, it suggested banning transactions by these individuals during specific time frames, unless there were extraordinary circumstances.<sup>1</sup> The Sachar Committee identified a number of people, including accountants, statutory auditors, company directors, tax and management consultants, and legal advisors, who may be involved in insider trading. It was suggested that all publicly traded companies keep a register that details transactions involving company stock by these people, their spouses, dependent children, and workers making more than a specific amount.

### **The Patel Committee:**

It was founded in 1984 to carry out a thorough examination of stock exchange operations, building on the work of the Sachar Committee. The committee gave careful consideration to India's lack of specific laws to prevent insider information abuse in its final report. Given that insider trading was common on Indian stock exchanges and a major contributor to excessive speculative activity, it suggested severe punishments for such offenses. The Patel Committee's conclusions demonstrated the pervasiveness of insider trading by naming not only insiders of the company but also people who worked for financial institutions, auditors, solicitors, and consultants and had access to confidential, price-sensitive data.<sup>2</sup>

### **Abid Hussein Committee (1989)**

Insider trading was further addressed by the Abid Hussein Committee, also known as the Working Group on Development of the Capital Market. The group suggested that insider trading be considered a serious crime that carries both criminal and civil penalties. The committee acknowledged the complexity of insider trading and covert takeover attempts and recommended that these problems could be primarily resolved by suitable regulatory actions.<sup>3</sup> Crucially, the Abid Hussein Committee suggested that the Securities and Exchange Board of India (SEBI), which would soon be formed, be given the responsibility of creating the

---

<sup>1</sup> Indian Law Watch, *Insider Trading: Journey of Legal Framework to Check the Practice*, Indian Law Watch (Jan. 13, 2021), <https://indianlawwatch.com/practice/insider-trading/>.

<sup>2</sup> Kumargaurav, *The Evolution of the Indian Stock Exchange: A Historical Perspective*, Medium (Apr. 18, 2023), <https://medium.com/@kumargaurav2511/the-evolution-of-the-indian-stock-exchange-a-historical-perspective-a8824c78dc0d>.

<sup>3</sup> The Inst. of Company Secretaries of India, *Role Played by SEBI in Restricting Insider Trading* (2018), <https://www.icsi.edu/media/portals/72/year%202018/presentation/ROLE%20PLAYED%20BY%20SEBI%20IN%20RESTRICTING%20INSIDER%20TRADING.pdf>.

required laws and the power to implement them. The foundation for SEBI's pivotal role in India's fight against insider trading was established by this recommendation.

### **Early Regulations and the Creation of SEBI:**

The Securities and Exchange Board of India (SEBI) was established in 1992 as a result of the committees' recommendations. The 1992 TISCO case, which emphasized the necessity of a specialized regulatory body to monitor corporate governance and market integrity, set off this turning point in Indian financial regulation. As soon as SEBI was established, it took action to combat insider trading. The first thorough attempt to define and outlaw insider trading in India was made in 1992 with the SEBI (Insider Trading) Regulations. These rules, which defined important terms like "insider" and "unpublished price sensitive information," set the groundwork for subsequent initiatives to stop this practice.<sup>4</sup>

### **Regulatory Framework & Key Provisions:**

The Securities and Exchange Board of India (SEBI), the top regulatory agency in charge of monitoring the securities market, is in charge of regulating insider trading in India. The creation and implementation of regulations aimed at preserving market integrity, safeguarding investor interests, and guaranteeing equitable and open market conduct are all included in SEBI's mandate. Through the implementation and enforcement of strict regulatory measures, SEBI plays a key role in preventing and discouraging insider trading activities within this regulatory framework. A key component of SEBI's regulatory framework, the SEBI (Prohibition of Insider Trading) Regulation, 2015, offers a thorough and reliable framework for controlling insider trading activities in India. The rule includes numerous clauses designed to improve market integrity, encourage transparency, and stop insider trading.

### **The main clauses of the 2015 SEBI (Prohibition of Insider Trading) Regulation:**

**Definition of Insider Trading:** The regulation outlines the definition of insider trading as well as the range of activities that are prohibited, including insider trading and the dissemination of unpublished price-sensitive information.<sup>5</sup>

**Prohibition of Insider Trading:** To avoid unfair advantages and guarantee fair competition for all market participants, the rule forbids insiders from trading in securities based on unpublished price-sensitive information.<sup>6</sup>

**Disclosure Requirements:** To ensure accountability and transparency in their transactions, insiders must notify the appropriate authorities of their trading activity and ownership positions within predetermined timeframes.<sup>7</sup>

**Trading Window and Blackout Periods:** Under the regulation, insiders are allowed to trade in securities during designated trading windows, subject to specific limitations.<sup>8</sup> Insiders are not allowed to trade outside of these trading windows in order to stop illegal transactions based on confidential information.

**Guidelines for Insider Trading:** Listed companies and market intermediaries are subject to the regulation's insider trading code of conduct, which outlines moral principles and best practices to stop

<sup>4</sup> Varun Kumar, *Formation of SEBI & Its Powers (Securities and Exchange Board of India Act, 1992)*, Law Audience (Oct. 14, 2018), <https://www.lawaudience.com/formation-of-sebi-its-powers-securities-and-exchange-board-of-india-act-1992/>.

<sup>5</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, reg. 2(1)(g), Gazette of India, pt. III, sec. 4, Jan. 15, 2015.

<sup>6</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, reg. 4, Gazette of India, pt. III, sec. 4, Jan. 15, 2015.

<sup>7</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, regs. 6–9, Gazette of India, pt. III, sec. 4, Jan. 15, 2015.

<sup>8</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, sched. B, cl. 4, Gazette of India, pt. III, sec. 4, Jan. 15, 2015.

insider trading and guarantee adherence to legal requirements. These clauses are important because they work together to promote an equitable, open, and effective securities market in India. The regulation aims to improve investor confidence and market integrity by outlawing insider trading and enforcing stringent disclosure requirements. In order to prevent market manipulation and guarantee fair competition for all market participants, trading windows and blackout periods have been established.<sup>9</sup>

**Critical Analysis:** An important step in guaranteeing market integrity and investor protection is the regulatory framework for insider trading put in place by the Securities and Exchange Board of India (SEBI), as described in the SEBI (Prohibition of Insider Trading) Regulation, 2015. A critical analysis, however, identifies both the advantages and disadvantages of SEBI's regulatory actions.<sup>10</sup>

### **Effectiveness of SEBI Regulation:**

Market participants now have a culture of compliance and awareness of insider trading thanks to SEBI's regulatory framework. Deterrents such as the ban on insider trading and the severe penalties for infractions have served to discourage illicit trading activities. Furthermore, the creation of trading windows and disclosure requirements have improved the securities market's accountability and transparency. Notwithstanding these favorable results, there are still issues with effectively implementing insider trading laws. The identification and examination of insider trading activity present a substantial obstacle. Because insider trading frequently entails complex techniques for hiding illegal transactions, it can be challenging for regulatory bodies to identify and bring criminals to justice. Furthermore, it can be difficult to spot instances of insider trading when there is a lack of timely and accurate information, particularly when transactions take place through opaque structures or offshore accounts.

The implementation of fines and sanctions against insider traders presents another difficulty. Although SEBI is able to enforce fines, profit disgorgement, and trading prohibitions, it is still unclear how effective these measures are at discouraging insider trading. There are often questions regarding the effectiveness of deterrence mechanisms because the fines levied may not be proportionate to the profits made from insider trading.<sup>11</sup>

Furthermore, the SEBI (Prohibition of Insider Trading) Regulation, 2015's effective implementation is hampered by regulatory ambiguities and gaps. The definition of "unpublished price-sensitive information" and the range of "connected persons" are two examples of the regulation's ambiguities, which cause inconsistent interpretation and application. Furthermore, the regulation ignores new problems like insider trading on social media and electronic platforms, underscoring the necessity of reviewing and updating regulatory frameworks on a regular basis to take into account changing market dynamics.

### **Areas for Improvement:**

A number of actions could be taken to address these issues and improve the efficacy of insider trading laws. First, in order to enhance surveillance and detection capabilities, regulatory bodies, exchanges, and market intermediaries must work together more and share information. Using cutting-edge technologies

<sup>9</sup> Chung-Hua Shen & Ting-Yu Li, *The Effect of Enforcement Intensity on Illegal Insider Trading Volume: The Case of Taiwan*, 13(2) Inv. Mgmt. & Fin. Innovations 141 (2016), [https://doi.org/10.21511/imfi.13\(2-1\).2016.02](https://doi.org/10.21511/imfi.13(2-1).2016.02).

<sup>10</sup> S.H. Uzma, *International Financial Reporting Standards Convergence in the Indian Context: Insights from Practitioners*, 23 J. Pub. Aff. (No. 3) (2023), <https://doi.org/10.1002/pa.2861>.

<sup>11</sup> Intelligent System for the Detection of Insider Trading in Indian Stock Market, EAI Endorsed Trans. Scalable Info. Syst. (Dec. 7, 2021), <https://doi.org/10.4108/eai.7-12-2021.2314574>.

like artificial intelligence and data analytics can improve the capacity to spot odd market activity and suspicious trading patterns.

Second, SEBI ought to concentrate on fortifying enforcement protocols and raising the severity of sanctions for transgressions involving insider trading. This entails investigating alternate sanctions, such as criminal prosecution for serious offenses, and enforcing disgorgement of profits that surpass insider trading gains. Furthermore, steps should be taken to expedite the resolution of disputes and streamline the adjudication process. Lastly, it is imperative that the current framework's regulatory ambiguities and gaps be addressed through recurring reviews and revisions. To address unclear provisions in the SEBI (Prohibition of Insider Trading) Regulation, 2015, SEBI should undertake a thorough review clause, take into account new developments, and conform to global best practices. Additionally, in order to enable investors to make knowledgeable decisions and support market integrity, initiatives should be undertaken to improve investor education and awareness regarding insider trading regulations.

Although SEBI's insider trading regulations mark a major advancement in preserving market integrity, a critical analysis identifies opportunities for enhancement. SEBI can improve its regulatory framework and guarantee an equitable, open, and effective Indian securities market by tackling enforcement issues, regulatory voids, and ambiguities.

### **Judicial Approach:**

*SEBI v. Hindustan Lever Limited (HLL)* <sup>12</sup>One of the first cases in which SEBI took action against insider trading was this one. Shortly before declaring a merger with another subsidiary, HLL had acquired a sizable number of shares from the Unit Trust of India. This was determined to be insider trading by SEBI's investigation, and the ruling was maintained on appeal. A more accurate definition of "unpublished" information was one of the changes made to the regulations as a result of this case.

Since it would otherwise be classified as information "published by the company," the Appellate Authority ruled that information does not need to be verified or authenticated by the business in order to be considered widely known. In accordance with the aforementioned Section 2(k) of the 1992 Regulations, the Appellate Authority evaluated the evidence presented by HLL, including a number of news articles discussing the merger, and came to the conclusion that the information about the merger was generally well known to the public, failing the first test to qualify as UPSI.

Additionally, HLL contended that the information about the merger of two profitable, healthy companies are not inherently price sensitive because price sensitivity would occur in the event of a merger between a strong and a weak company, which would affect the companies' share prices. However, the Appellate Authority pointed out that there are synergistic opportunities even when two healthy businesses merge, which could make either company more sensitive to price changes. As a result, the Appellate Authority concurred with SEBI's determination that merger information was price sensitive, even if it wasn't "unpublished."

*Reliance Industries v SEBI* <sup>13</sup> The Supreme Court ruled that SEBI has an obligation to act fairly when conducting its business or taking legal action against parties because it is a regulator. Since SEBI is a quasi-judicial organization, it is required by the constitution to operate fairly and in accordance with the laws. A regulator has an obligation to address problems rather than figuring out ways to circumvent the

---

<sup>12</sup> [1] (1998) 18 SCL 311 MOF

<sup>13</sup> [2004]55SCL81(SAT)

law in order to secure successful convictions. This obligation is inextricably linked to the natural justice principles, which state that each party must be given a fair chance to present their case. The SC's addition of a warning against bringing pointless criminal lawsuits against big businesses was another significant feature of this ruling. The Supreme Court ruled that the courts must serve as "gatekeepers" in commercial matters and that the start of such criminal proceedings must be done after considerable deliberation. The SC provided the justification for this warning, stating that such criminal activity would have long-term negative economic effects on the country. Therefore, the regulator must proceed with caution before taking such measures.

### **Key findings & Insights:**

**Regulatory Framework:** The Securities and Exchange Board of India (SEBI) is a key player in overseeing the securities market, and India has one of the strongest insider trading laws in the world. A comprehensive framework designed to stop insider trading and support market integrity is the SEBI (Prohibition of Insider Trading) Regulation, 2015.

**Enforcement Issues:** In spite of the strong regulatory framework, there are still issues with efficiently implementing insider trading laws. The intricacy of illicit trading practices and the complexity of financial markets make it even more difficult to detect and investigate insider trading activities.

**Ambiguities and Gaps:** Consistent enforcement of insider trading laws is hampered by ambiguities in the interpretation of important provisions, such as the knowledge requirement. Additionally, the current regulatory framework needs to be reviewed and improved due to regulatory gaps, such as the lack of an innocent tippee defense.

**Case Study Consequences:** Case studies that shed light on how insider trading laws are interpreted and applied in India include *Shruti Vora v. Securities and Exchange Board of India*.<sup>14</sup> These cases highlight how insider trading disputes must be decided with precision, uniformity, and respect for the legislative intent.

### **India's Insider Trading Regulation Challenges:**

Even though there has been great progress in creating a strong regulatory framework, there are still a number of obstacles to overcome in order to effectively combat insider trading in India: Evidence-Based Obstacles: Because there is frequently insufficient direct evidence, proving insider trading cases can be challenging. It is difficult to draw a direct connection between having inside knowledge and subsequent trading activity because such transactions are confidential.

**Criminal Liability:** Although insider trading cases are subject to criminal liability under the regulations, putting these provisions into practice has proven difficult. In insider trading cases, proving mens rea (criminal intent) is especially difficult, and accused parties frequently escape criminal prosecution and only face civil penalties.

**Cross-Border Issues:** Insider trading frequently crosses national boundaries in this age of global finance. In terms of jurisdiction and international collaboration in investigations and enforcement, this poses difficulties.

---

<sup>14</sup> CIVIL APPEAL NOS.2252-2262/2021

**Regulation and Market Efficiency:** The proper amount of regulation is a topic of continuous discussion. Although stringent regulations are required to preserve market integrity, excessively onerous rules may impair market liquidity and efficiency.

**Investor Protection and Compensation:** The issue of compensating investors who may have lost money as a result of insider trading is frequently not sufficiently addressed by current regulations.

**Recommendations:**

**Improve Enforcement Mechanisms:** To effectively identify and discourage insider trading, bolster surveillance and investigative capacities. This could entail utilizing cutting-edge technologies, improving regulatory authorities' coordination, and allocating more funds for enforcement initiatives.

**Make Regulatory Provisions Clear:** Clarify important clauses like the knowledge requirement and the range of acceptable defenses to resolve any ambiguities in the insider trading laws. To guarantee alignment with global best practices and market dynamics, the regulatory framework must be reviewed and updated on a regular basis.

**Encourage the education of investors:** Boost investor education and awareness campaigns to enable market players to identify and report questionable trading practices. A more watchful and knowledgeable investor community can result from educating investors about their rights and obligations under insider trading laws.

**Encourage Cooperation:** To improve market surveillance, exchange best practices, and jointly handle new issues, encourage cooperation between regulatory bodies, market players, and industry stakeholders. Partnerships between the public and private sectors can strengthen regulatory initiatives and encourage a compliance culture.

**Conclusion:**

For India's financial markets, insider trading is still a complicated and difficult problem. Even though a thorough regulatory framework has advanced significantly, persistent difficulties with detection, enforcement, and prosecution underscore the necessity for the insider trading regime to continue evolving. Because insider trading is complex, regulation and enforcement must take a comprehensive approach. This entails fortifying legal frameworks, boosting detection capabilities, enhancing corporate governance procedures, encouraging global collaboration, and raising investor awareness and education. It is impossible to overestimate the significance of preserving market integrity through efficient insider trading regulation as India's markets develop and become more integrated with the global financial system. India can continue to fortify its defenses against insider trading by absorbing knowledge from global best practices, utilizing technology breakthroughs, and cultivating a culture of moral conduct and openness. In addition to safeguarding individual investors, this will improve the general integrity and effectiveness of India's financial markets, promoting their stability and long-term growth. Creating a level playing field where all market participants have equal access to information and opportunities is the ultimate goal of insider trading regulation. Even though there are still obstacles to overcome, India's continuous attempts to strengthen and implement insider trading laws are an essential first step in accomplishing this objective and building a strong, open, and reliable financial market environment.