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## WHAT LIES INSIDE INSIDER TRADING? A LEGAL LOOPHOLE OR A STRATEGIC ADVANTAGE

### Abstract

This article examines some aspects of insider trading within India specifically focusing on individuals who possess confidential information capable of influencing the market. The study differentiates authorized from unauthorized forms of insider trading while looking into a landmark case that involved Rakesh Agarwal against Securities Exchange Board India (SEBI) to illustrate how regulatory measures are implemented. The article takes into account some of the key points that have been raised concerning whether the purpose served by insider trading outweighs its negative impact on fairness and efficiency in functioning of markets. It indicates how insider trading affects market dynamics, investor confidence as well as integrity of financial markets on a broader scale. However, it reinforces the idea that such practices should be seen as unacceptable because they undermine market integrity and institutional ethics. It also emphasizes upon the existence of tough regulatory structures for ensuring fairness in operation for all investors.

### Introduction to Insider Trading

Insider Trading is a term used to describe an unethical and illegal action in which a person acquires price sensitive information about a company while serving as an insider and then misuses it by buying or selling securities for his own benefit. Insiders are generally considered to be directors, corporate officers, lawyers, bankers, accountants or major shareholders who have privileged access to undisclosed material price-sensitive information about the company because of their position or special relationships with the firm. Section 2 (e) of the SEBI (Prohibition of Insider Trading) Regulations, 1992 ("SEBI Regulations") defines an 'insider' as:

1. Any person: (a) who is or was connected with the company, or (b) is deemed to be connected with the company, and
2. Such person: (a) is reasonably expected to have access to unpublished price sensitive information in respect of securities of a company, or (b) has received, or (c) has had access to information.

However, possession of price sensitive information does not automatically qualify someone to be an insider. When a person takes advantage of his position by breaking the trust bestowed upon him by others or any fiduciary duty arising from it then he is committing the crime called “insider trading”. In addition there must be an element of material gain involved for such an individual. Under Regulation 4 of SEBI Regulations, any act constitutes insider trading if indulged in by an insider as per Regulation 3:

1. Deals in securities of a listed company either for himself or on behalf of another person while in possession of any unpublished price sensitive information.
2. Communicates, counsels or procures directly or indirectly any unpublished price sensitive information to another person.

### **The Rakesh Agarwal vs SEBI Case**

India was rocked by a seismic event in 1996, the infamous Rakesh Agarwal versus SEBI clash that brought insider trading into the spotlight, casting a shadow over the integrity of the stock market. At the center of this matter, was the Managing Director of ABS Company Pvt. Ltd. His company was in negotiations to buy 51 percent of the shares from German company Bayer A.G. Rakesh Agarwal informed his brother-in-law about the same and instructed him to purchase shares of the Company from the market. However, he was found guilty for insider trading and was fined a hefty amount of Rs 34 lakhs payable to Investor Education & Protection Fund (IEPF). However, the appellate authority overruled the order on the ground that the motive/intention of the insider has to be considered and he did not gain any unfair advantage and was thus not guilty. However, this makes it worth noting that insider trading isn't always black and white. Legitimate instances exist, where authorized individuals engage in securities transactions based on their access to sensitive private information. So what is the distinguishing line that defines legal or illegal insider trading?

### **When is Insider Trading Considered Illegal?**

Trading of securities based on legal guidelines is considered legal insider trading in India. The insiders must disclose their trades and any material information they have that is not public to the market regulatory agencies. Confidential information should not be used by them for self enrichment and they must publish it at a set time. At the same time, illegal insider trading takes place when insiders trade securities with undisclosed material information about a particular security. This can entail manipulation of the market or violation of laws relating to securities. It may include penalties like fines, imprisonment or civil remedies imposed by regulators.

### **The Pros of Insider Trading**

Nonetheless, despite its bad reputation, insider trading does have some advantages. By enabling private information to be priced into stocks faster, insider trading can help make markets more efficient as well as benefit investors who are able to profit from such actions. While still giving them an early look at things that will become known over time but at a later date, such kind of securities permit investors to take advantage of emerging patterns and trends in the marketplace before any changes occur in it thereby helping them make informed choices as to what's happening within this sector and consequently making stock prices more accurate by incorporating valuable non-public data. This therefore has the potential to increase market liquidity as investors are generally more willing to participate in trades knowing they have access to greater and much more accurate information.

### **The Cons of Insider Trading**

The issue with insider trading is that it's a slippery slope. Though, insider trading has its own merits; at the same time, it still undermines equity and integrity of the markets. Small investors cannot measure up to those who have access to the privileged information of companies. This discrepancy in availability of information leads to ineffectiveness and disrupts control mechanisms aimed at maintaining market steadiness. It might appear like an easy way to make quick cash but more often than not it ends up being very costly—not just in terms of fines and penalties but also in relation to damages to reputation and other legal issues. Thus, while insider trading may offer advantages to some, it ultimately undermines market integrity and fairness.

### **Conclusion**

Insider trading isn't just a problem for regulators and industry insiders—it's a problem for all of us. The whole issue of insider trading has cast doubt over the stock exchange market, thereby affecting even common investors who are naive and inexperienced when it comes to investment matters. In India, SEBI is assigned with the task of regulating the market. Unfortunately, it has not been very successful in its efforts to curb insider trading. Though its role is to safeguard investors and build confidence in the market, SEBI has been weak in enforcing this with fines often not deterring errant ones. Having said that, what's the ultimate solution? Well, firstly we must indict those who engage in insider trading and make them take the responsibility for their actions. This can be achieved by having more stringent regulations that impose heavy penalties on offenders. It also includes building an industry where integrity and honesty are highly valued through transparency fostering culture. We can help ensure that the markets remain a level playing ground for everyone by coming together to expose corruption as well as promoting fairness and transparency in the entire process. And who knows? With a little bit of luck and a whole lot of hard work, we might just be able to make the world of investing a little bit friendlier for everyone.

## Citations

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