V. COMBATTING INSIDER TRADING IN INDIA: DETERMINING EXISTING LOOPHOLES AND EFFECTIVE DETERRENTS

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ABSTRACT

Despite severe consequences capable of causing reputational damage, and the existence of stringent laws and regulations specifically designed to curb insider trading, the violations and leakage of unpublished price-sensitive information have become more common. The cases being probed by the Securities and Exchange Board of India have rapidly increased from 10 to 20 percent during Financial Year (FY) 2003-18, to over 30 percent during FY 2019-21. Yet, the rate of conviction in these cases remains significantly low. This implies that flaws and gaps persist which impede the effectiveness of the laws prohibiting insider trading. There are several layers involved in regulating the cases of insider trading, *viz*., legislation, investigation, prosecution, and conviction. This paper delves deeper into the concept with the main aim to determine the stage at which the loopholes largely persist structurally within the regulatory regime and the issues which plague that specific layer in India. The paper also attempts to ascertain effective deterrents for combatting insider trading in the context of India. Further, since research indicates that developed countries have a better record of prosecution than emerging markets, this paper seeks to examine the laws and experiences of one of such developed countries, the United States of America, known to have the most robust and vigorous regulations and prosecution of insider trading cases globally, and determine whether the practices followed in the U.S. are suitable for the regulatory/enforcement culture in India. Some of the findings of this paper reveal that SEBI lacks sufficient investigative tools and mechanisms to effectively prosecute an insider trading case. The loophole majorly persists at the investigation and conviction level. Research shows that even the laws in the U.S. face criticism for being ambiguous in nature, particularly regarding the definition of insider trading. However, the main reason behind the effective regulation of insider trading in the U.S. is the fact that the Securities Exchange Commission in the U.S. has powerful investigative tools, and the U.S. leverages technology to effectively investigate the cases, and imposes strict penalties on the convicts of insider trading. Moreover, research suggests that in order to effectively deter insider trading, allocating adequate resources towards this effort is just as essential as enacting and formulating relevant laws and regulations. SEBI requires access to advanced technological tools to enhance its ability to detect instances of insider trading at a nascent stage. Further, to ensure the highest level of protection against insider

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trading, it is imperative to adopt precautionary measures like safeguarding material non-public information and implementing strong corporate controls and compliance policies. Imposing strict penalties on the convicts and longer incarcerations are also some of the measures that have aided the U.S. and the U.K. in reducing the incidences of insider trading cases.

I. INTRODUCTION

In India, Insider Trading is defined as, "Trading of shares by an 'insider' based on unpublished price sensitive information ("**UPSI**").[1] When the trading is based on such non-public, material information, it is considered illegal. However, trading based on publicly available information is considered legal.[2] Insider trading is a serious issue as it disrupts businesses and contaminates the whole stock market. Thus, it is imperative to have robust laws which eliminate this vice from its roots.[3] Insider trading not only undermines the integrity and fairness of the stock markets but also poses a problem for the international financial markets. Almost every country prohibits insider trading to promote investor confidence, and market efficiency

[1] Maulik Madhu, 'All you wanted to know about insider trading' *The Hindu Business Line* (7 June 2021) <https://www.thehindubusinessline.com/opinion/columns/slate/all-you-wanted-to-know-about/article34755136.ece> accessed 2 February 2022.

[2] James H. Thompson, 'A Global Comparison of Insider Trading Regulations' [2013] IJAFR <https://www.macrothink.org/journal/index.php/ijafr/article/viewFile/3269/2976> accessed 7 May 2022.

[3] Mahendra Tiwari and Deepshikha Sharma, 'Brewing Insider Trading Provision in India with E-Governance' [2021] EEO 6795 <http://ilkogretim-online.org/fulltext/218-1620490515.pdf?1643663745> accessed 2 February 2022.

and enhance the integrity of the financial markets.[4] In India, Section 12A(d) of the Securities and Exchange Board of India Act, 1992 prohibits insider trading.[5] While the common perception is that insider trading is inefficient (bad) for some firms, it is also contended by some law and economics scholars that it might be efficient (good) for some firms, thus firms must be free to regulate their insider trading privately through contracts on a case-to-case basis, as opposed to regulating all corporations under a common umbrella of one single statute.[6] Professor Henry Manne initiated the discourse on the efficiency inquiry of insider trading by arguing in his thesis that contrary to the prevailing legal and moral opinion at the time, insider trading is desirable because it is economically efficient.[7] The former claim regarding inefficiency pertaining to insider trading is a more common one as insider trading is generally believed to disrupt businesses, ruining their reputation and eventually leading them to losses. The latter claim regarding the possibility of insider trading resulting in more efficiency for some firms is a rare one. The reason why some law and economics scholars believe this is because they believe that in certain cases, insider trading might be beneficial for both, the company and the investors/shareholders, as insider trading may motivate entrepreneurial innovation and enhance the efficiency within a firm. According to its proponents, the entrepreneurs would be rewarded in direct

[4] Liu Duan, 'The Ongoing Battle against Insider Trading: A Comparison of Chinese and U.S. Law and Comments on How China Should Improve Its Insider Trading Law Enforcement Regime' [2009] DB LJ 129 <https://heinonline.org/HOL/LandingPage?handle=hein.journals/duqbuslr12&div=10&id=&page=> accessed 2 February 2022.

[5] Securities and Exchange Board of India Act, 1992, Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015.

[6] Laura N. Benny, 'Insider Trading Laws and Stock Markets Around the World: An Empirical Contribution to the Theoretical Law and Economics Debate' [2007] J. Corp. L. 32 <https://repository.law.umich.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1053&context=articles> accessed 8 May 2022.

[7] ibid.

proportion to their innovations. In simpler terms, efficiency implications propounded by Prof. Manne in his thesis are that an insider, through a piece of non-public information, can profit by buying the Company's shares before the public learns about the innovation, this in turn has the potential to lead to a rise in the Company's value and the insider can make profits by sharing the shares at a higher price after the information is available. If the insider is wealth-constrained and is not capable of buying unlimited shares, they can also make profits out of selling the information itself.[8]

Earlier, insider trading was considered a concern peculiar to the United States.[9] The U.S. was the first country to have ever discussed the insider trading phenomenon in the case of *Strong v. Repide,*[10] In 1909. In this case, the Supreme Court laid down that a company director had the power to influence the value of shares of his company, thus keeping his expected plans and actions a secret from the public, and buying or selling his shares based on material information would be deceitful and fraudulent. This case lead to the foundation for insider trading laws in the U.S., however, the statutory regulations came into place only decades later with the introduction of the Securities Act, 1933. For the longest time, the U.S. had the most robust and vigorous regulations and prosecution of insider trading cases of any country. Even though in the U.S. the opinions on insider trading vary, the members of Congress, and the courts, time and again justified restriction on insider trading, claiming that it defends the notion of fairness, curtails the integrity of capital markets, and breaks the confidence of the public in the system.[11] In this paper,

[8] ibid.
[9] Harvey L. Pitt, 'Games without Frontiers: Trends in the International Response to Insider Trading', [1992] 55 L & Contemporary Problems 199 <https://doi.org/10.2307/1192109> accessed 8 May 2022.
[10] 213, U.S. 419 (1909).
[11] Pitt (n 9).

comparisons and contrasts are being drawn between the insider trading laws in the U.S. and India, inter alia because, (a) U.S. is one of the largest democracies in the world after India, (b) U.S. was the first country to introduce insider trading laws, it has the most comprehensive and effective insider trading laws,[12] and the stiffest penalties in the world,[13] (c) these laws in the U.S. have constantly evolved and developed constantly since their introduction,[14] (d) plethora of scholarly work demonstrates that developed countries have a better record of tackling insider trading cases than developing countries,[15] (e) India and the U.S., are both common law countries and the system of law in both countries largely depends on court precedent in formal adjudications, (f) Insider trading laws in the U.S. are widely considered the strongest 'best practice' and other countries have been significantly influenced by its laws on the subject, (g) the Division of Enforcement 2020 Annual Report revealed that the Securities Exchange Commission (**"SEC"**) in the U.S. has been highly successful in detecting and punishing people involved in Insider Trading.[16]

This paper is divided into three parts. The overarching questions that this paper attempts to answer are:

[12] Nishith M. Desai and Krishna A. Allavaru, 'Insider Trading: A comparative study' Nishith Desai Associates Opinion paper, Pg. 8 [1997] <http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Associates_Insider_Trading_-_A_Comparative_Study.pdf> accessed 29 June 2022.
[13] U.S. Securities and Exchange Commission, Press Release <https://www.sec.gov/news/pressreleases> accessed 29 June 2022.
[14] Pitt (n 9).
[15] Utpal Bhattacharya and Hazem Daouk, 'The world price of insider trading' [2002] TJF 75 <http://www.jstor.org/stable/2697834> accessed 2 February 2022.
[16] U.S. Securities and Exchange Commission, *Division of Enforcement Annual Report* (2020), Pg. 14 accessed 30 June 2022.

- Whether the present insider trading regulations, i.e., the Securities and Exchange Board of India Act, 1992, and the rules and regulations made thereunder, effectively combatting insider trading in India?

- Since several layers are involved in regulating the cases of insider trading, *viz*., legislation, investigation, prosecution, and conviction, at which stage do loopholes largely persist structurally within the regulatory regime and the issues which plague that specific layer thereby hindering the effective regulation of insider trading in India?

- How can insider trading be combatted in India?

The first part is titled 'Insider Trading in the U.S'. This part sheds light on the history of insider trading in the U.S. and analyzes how the prosecution of insider trading cases has evolved since the introduction of insider trading regulations. This part also discusses the multi-faceted theories of insider trading recognized in the U.S., *viz*, classical theory, the misappropriation theory, and the parity of information theory.The second part titled 'Insider Trading in India: History & Evolution' discusses the contributions made by various committees in the insider trading laws in India.

The third part titled 'Combatting Insider Trading: Effective Deterrents' seeks to determine the existing loopholes in the current insider trading regime and examine the applicability and suitability of incorporating the practices followed in the U.S. in the Indian context, thereby also highlighting the criticisms attached to the laws in the U.S. It is acknowledged that rarely any legal system is perfect, and there may be certain loopholes in the laws in the U.S. as well, however, lessons from the U.S. may still present a better way forward in dealing with the insider trading cases in India. Further, the paper

concludes by providing a general summary and reiterating the findings of the paper.

II. INSIDER TRADING IN THE U.S.

A. Tracing The History

In 1909, the U. S. was the first country to have ever discussed the insider trading phenomenon in the case of *Strong v. Repide*.[17] The Supreme Court of the United States, in the aforementioned case laid down that a company director had the power to influence the value of shares of his company, thus keeping his expected plans and actions a secret from the public, and buying or selling his shares based on the knowledge and awareness regarding material information would be deceitful and fraudulent. The Supreme Court established 'the insider rule' which barred the director of a company from trading if he knew any material non-public information, or mandated them to disclose it to the public before trading upon such information. However, this case did not lay down the definition of who an 'insider' was or what constituted 'insider trading'.[18] Though this case lead to the foundation for the recognition of insider trading cases, the statutory regulations came into place decades later with the introduction of the Securities Act, 1933, and the Securities Exchange Act, 1934.[19] The Securities Act covers issues about securities, while the Securities Exchange Act particularly aims at protecting stocks. Sections 16(b) and 10(b) of the Securities Exchange Act outlaw unlawful trading practices and explain using various rules of the U.S. SEC, the meaning of fraudulent trades, and by whom

[17] 213, U.S. 419 (1909).
[18] Bhattacharya (n 15).
[19] Pitt (n 9).

they can be perpetrated. The 1934 act also denotes when a trade is considered unlawful.[20]

In *SEC v. Texas Gulf Sulphur Company,* the United States Court of Appeals for the Second Circuit held that if any person has non-public information about stocks or securities of a firm, he has a duty to either disclose the same to the firm, its stockholders, and the public so they can benefit from it as well or not trade based on the undisclosed information at all.[21] In *United States v. Newman,* the court for the first time made it illegal for a nonrelated/an outsider party to engage in trades based on non-public information. Although the person, in this case, was not held liable for engaging in insider trading as he did not benefit from the transaction, it was further clarified that engaging in trading based on non-public information even by an outsider is illegal.[22]

B. Theories of Insider Trading in the U.S.

1. The Classical Theory

The U.S. recognizes the 'classical theory' of insider trading which stipulates that "a finding of liability is based in fraud" and thus, an insider is required to follow the "abstain or disclose rule", wherein, an insider who trades without prior disclosure is in breach of fiduciary duty to their companies. This rule was laid down in the case of *Cady, Roberts & Co*.[23] The Supreme Court interpreted Section 10(b) of the Securities Exchange Act of 1934 and stated that if an insider does not disclose the insider information and all material available to him, he must abstain from trading. Thereby, indicating that not only trading upon such information is offensive but also the omission

[20] The Securities Act, 1933; the Securities Exchange Act, 1934.
[21] 2 A.L.R. Fed. 190.
[22] 773 F.3d 438 (2014).
[23] 40 S.E.C. 907 (1961).

of disclosure. The court recognized that since the insiders act on behalf of the corporation and have the information simply by the virtue of their relationship with the company, allowing them to take advantage of such a relationship would be unfair in the case of non-disclosure. Chief Justice Burger, in his dissenting opinion, went a step further to state that the language of Section 10(b) and Rule 10b-5 recognized "any person engaged in any fraudulent scheme" as an insider, thereby extending the ambit of insider trading out of the "corporate insiders" dealing just with "corporate information". Consequently, it also means to impose an absolute duty to disclose or abstain from trading using such misappropriated undisclosed information.[24]

In the case of *Dirks v. SEC*, the Supreme Court clarified that merely because an insider receives material, non-public information, a duty cannot be imposed on him to disclose or abstain. It further clarified that a fiduciary duty is breached when the non-public information has been disclosed by the shareholder to the tippee in breach of his fiduciary duty and the tippee is aware of such breach. Moreover, the 'purpose of disclosure' was also emphasized to be of importance in such cases, as the purpose must be to make a direct or indirect personal gain through such breach.[25]

2. The Misappropriation Theory

This theory treats UPSI as a property, or commodity owned by a corporation.[26] Thus, any unauthorized use of such information is considered to be a theft of intellectual property. In the case of *Carpenter v. United States*, the Supreme Court recognized that the petitioner intended to take the UPSI

[24] Prateek Bhattacharya, 'India's Insider Trading Regime: How Connected Are You?' (2019) 16 NYU JL & Bus1.
[25] 463 U.S. 646 (1983).
[26] Bhattacharya (n 24).

which was recognized to have property rights, to make profits/personal gains.[27] Further, in the case of *United States v. O'Hagan*, the Supreme Court held a lawyer accountable for insider trading when he breached his fiduciary duty by misappropriating information from the law firm he worked at, thereby, deceiving the ones who entrusted him with access to such UPSI.[28] The Court also highlighted that this theory applies in situations wherein information is misappropriated through manipulation and deception.[29]

3. The Parity of Information Theory

This theory stipulates trading on UPSI irrespective of how an investor received access to such information, thus, any kind of trading based on UPSI would be illegal under this theory.[30]

III. INSIDER TRADING IN INDIA: HISTORY AND EVOLUTION

A. Contributions of Various Committees in Developing Statutes

1. P.J. Thomas Committee

In India, for the first time in 1948, the P.J. Thomas Committee was constituted to restrict insider trading. The committee was required to assess and recommend suitable actions which would help in curbing the cases of insider trading. This committee made suggestions related to disclosure obligations and restrictions that must be imposed upon stock market traders who made "short-swing profits".[31] The recommendations of this committee

[27] 484 U.S. 19, 22 (1987).
[28] 'Insider Trading', *Legal Information Institute*, Cornell Law School <https://www.law.cornell.edu/wex/insider_trading> accessed 30 June 2022.
[29] U.S. 642 (1997).
[30] Bhattacharya (n 24).
[31] ibid.

were incorporated in Sections 307 and 308 of the erstwhile Companies Act, 1956. The recommendations required mandatory disclosures by the managers and directors of the company. However, even though the committee was successful in establishing the need for regulation of insider trading in India, it was not so successful in preventing illegal insider trading.[32]

2. Sachar Committee and Patel Committee

In 1978 and 1986, the Sachar Committee and Patel Committee, respectively, reviewed the shortcomings of the insider trading laws in India and suggested measures to prevent insider trading as well as recommended enacting a statute specifically to regulate insider trading. The Patel Committee laid down the definition of Insider Trading as, "*Trading in the shares of a company by the person who is in the management of the company or is close to them based on undisclosed price sensitive information regarding the working of the company, which they possess but which is not available to others*".[33]

Later in 1992, upon the recommendation of the aforesaid committees, the Securities and Exchange Board of India (SEBI) (Prohibition of Insider Trading) Regulations, 1992 were enacted under section 30 of the SEBI Act, 1992. However, loopholes persisted even in this legislation, which was subsequently amended through the 2002 amendments. Ever since, the laws have been amended twice, the latest one being amended in April 2019.[34]

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[32]ibid.

[33] Sonakshi Das, 'The Know-all of Trading - Decades of Corruptive Prevention', (2015) academike <https://www.lawctopus.com/academike/know-insider-trading-decades-corruptive-prevention/> accessed 8 May 2022; *Insider Trading Regulations – A Primer*, *Report by Nishith Desai Associates*, <http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Insider_Trading_Regulations_-_A_Primer.pdf> accessed on 8 May 2022.

[34] Bhattacharya (n 24).

Insider trading is governed by the SEBI Act of 1992 read with the regulations thereunder.

3. N.K. Sodhi Committee

Over the years, since the inception of the SEBI (Prohibition of Insider Trading) Regulations, 1992, the laws have evolved and the onus on companies has now increased to protect price-sensitive information.[35] In 2015, the recommendation of Justice N.K. Sodhi's committee was adopted which proposed that the model code of conduct should be principle-based rather than rule-based, as it would help better prevent leakage of price-sensitive information. The concept of trading plans was also introduced at this time, which mandated the insiders to announce their plans of buying or selling well in advance. In 2017, the T.K. Vishwanathan Panel Report recommended that organizations introduce policies and procedures to enquire whenever material information gets leaked. It also prohibited communication and access to UPSI. However, it permitted communication that was done for any legitimate purpose as a part of due diligence.[36] Following this, certain amendments were incorporated ("**2019 Amendments**"), and the 2015 PIT Regulations were revised and made effective from April 2019.

[35] Palak Shah, 'Price Rigging Down, Insider Trading Up' *Business Line* (Mumbai, 15 February 2021) <https://www.thehindubusinessline.com/markets/stock-markets/price-rigging-down-insider-trading-up/article33836372.ece> accessed 8 May 2022.

[36] Jayshree P. Upadhyay, 'How India Cracks Down on Insider Trading' *Mint* (Mumbai, 28 January, 2020) <https://www.livemint.com/market/stock-market-news/how-india-cracks-down-on-insider-trading-11580199120367.html> accessed 8 May 2022.

IV. Combatting Insider Trading

A. Determining Existing Loopholes

Despite having proper regulatory frameworks for insider trading, the cases of insider trading have been consistently rising and were highest in the last financial year. An article in the Mint highlighted that in the last three decades of SEBI's existence, there has not been a single conviction in an insider trading case.[37] Even when in the financial year 2018-19 and 2019-20, SEBI detected a total of 119 insider trading cases, a number significantly higher than those detected by SEBI in any of the previous years.[38] This indicates that the detection rate in insider trading cases is still low in India. The lack of proper surveillance tools is one of the major reasons why SEBI has failed in connecting the dots, establishing links, and collecting evidence to unravel a complete case.[39]

As per SEBI's 2019-20 Annual Report, it investigated 85 cases and could complete only 25 by 2021.[40] Upon examining the proceedings, the reason which was traced was that the majority of these cases involved a lack of disclosure and trading on alleged insider information. Neither the link of the communication could be established, nor who benefitted from the information could be traced. Even in the financial years between 2011 to 2017, SEBI had only completed probes in about 10-30 cases each year.[41] Further, the Handbook of Statistics released by SEBI indicated that 57 cases were completed in the year 2019-2020, but there were no convictions in any of the

[37] ibid.
[38] Securities and Exchange Board of India, *Annual Report: 2020-21*, <https://www.sebi.gov.in/reports-and-statistics/publications/aug-2021/annual-report-2020-21_51610.html> accessed on 28 June 2022.
[39] Upadhyay (n 36).
[40] Securities and Exchange Board of India, Annual Report: 202-21.
[41] ibid.

cases until 2017, and there is no data on the convictions of the following years until 2022.[42]

As per the Mint article, the biggest reason behind the low prosecution rate in insider trading cases in India is the fact that SEBI is not empowered with the basic investigative powers and tools to detect insider trading at an earlier stage.[43] SEBI was only granted the authority to access phone call records in 2014, and to this day, it does not possess such powers. In order to effectively convict those involved in insider trading, SEBI introduced an Informant Mechanism – as per this mechanism, anyone who assisted in leading a case of insider trading towards conviction would be rewarded with a hefty ₹1 crore rupees. This was introduced with the aim to benefit the regulator, company, shareholder as well as informant as they would be making monetary gains.[44] However, there is no data so far on how helpful this incentive has been.

A Business Standard's report revealed that Vaneesa Agrawal, founder of a law firm, and former SEBI official, said, "There is a limitation on the number of investigations that can be undertaken with limited resources". It was also emphasized that when the authorities are also responsible for investigating cases of violations other than insider trading, the probes of insider trading are affected adversely. [45]

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[42] Table 80, Table 81 and Table 82, Handbook of Statistics 2020, Securities and Exchange Board of India <https://www.sebi.gov.in/reports-and-statistics/publications/may-2021/handbook-of-statistics-2020_50238.html> accessed on 30 June 2022.
[43] Upadhyay (n 36).
[44] Jayshree P. Upadhyay, 'How India Cracks Down on Insider Trading' *Mint* (Mumbai, 28 January, 2020) <https://www.livemint.com/market/stock-market-news/how-india-cracks-down-on-insider-trading-11580199120367.html> accessed 8 May 2022.
[45] Sachin P. Mampatta, 'Market Regulator SEBI Turns its Glare on Insider Trading, Shows Data' *Business Standard* (Mumbai, 26 January 2022) <https://www.business-standard.com/article/markets/markets-regulator-sebi-turns-its-glare-on-insider-trading-shows-data-122012600067_1.html> accessed 8 May 2022.

SEBI has limited access to a technology-driven investigative process unlike the SEC, SEBI still cannot wiretap phone calls, which has been instrumental for SEC in prosecuting insider trading cases. This inevitably makes obtaining information more difficult. Furthermore, sharing information that may have personal details or communications via WhatsApp, would also be against the right to privacy envisaged in the constitution of India as a fundamental right, and also raise concerns regarding data privacy.[46]

Historically, SEBI has handled cases with extreme softness. Under Section 15G of the SEBI Act, 1992, it has the power to impose a penalty that can range up to INR 25 crores or three times the profit that is made through insider trading, whichever is higher. However, the maximum penalty SEBI has imposed till date is INR 5.5 crores in the case of Shelter Infra Projects Limited.[47] Moreover, there is also a major human resource crunch in the SEBI. The nature of insider trading investigations is time-intensive and the lack of technological resources makes it an even more cumbersome process to prosecute the cases in a timely and effective manner.[48]

B. Lessons from the U.S.: Determining Effective Deterrents

One of the biggest lessons to learn from the U.S. is that to curb insider trading, resources devoted to enforcement might be just as important as the enactment and formulation of the statutes, regulations, and legal prohibition. The mere enactment of a law does only so much to gain investor confidence in both domestic and international parlance and sometimes the impact is even

[46] Bhattacharya (n 24).
[47] Press Trust of India, 'SEBI imposes Rs. 5.5 Cr. Penalty in Shelter Infra Projects case' *Business Standard* (Mumbai, 7 March 2014) <https://www.business-standard.com/article/companies/sebi-imposes-rs-5-5-cr-penalty-in-shelter-infra-projects-case-114030700877_1.html> accessed 30 June 2022.
[48] Bhattacharya (n 24).

nil. It is only when the cases are prosecuted and convictions are made, that investors gain confidence in the system. As per Gevurtz, the enactment of laws prohibiting an act merely helps in reflecting the disapproval of society towards a particular act, it does not help in actually decreasing the commission of such illegal acts. More resources must be devoted to enforcement rather than enactment as simple enactment of laws might just shift the communication of inside information into more subtle forms.[49]

As stated in the Division of Enforcement 2020 Annual Report, the SEC uses strict mechanisms to detect cases of insider trading at the earlier stages by establishing robust corporate controls and compliance policies, and also by safeguarding the material non-public information.[50] The UK and the U.S. alike, have installed sophisticated computer surveillance software systems which help in tracking insider trading, by flagging when there is an unusual swing in the price or volume of the securities.[51] Such technological advancement has not seen the light of day in India, but SEBI must be equipped with more technology.[52] There are enough resources in India to make it possible once the Supreme Court allows SEBI to get access to more technological tools.

The SEC also brings enforcement actions against professionals who allegedly misappropriate and trade on material non-public information. The successful prosecution of insider trading cases mentioned in the Division of

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[49] Franklin A. Gevurtz, 'The Globalisation of Insider Trading Prohibitions' [2002] 15 Transnat'l Law. 63 <https://scholarlycommons.pacific.edu/cgi/viewcontent.cgi?article=1012&context=facultyarticles> accessed 8 May 2022.

[50] Division of Enforcement Annual Report (2020).

[51] Madhav Misra, 'Insider Trading: Indian Perspective on Prosecution of Insiders' (2011) 18 J Fin Crime 162

[52] Rahul Mehta, 'The Redundant Nature of Prevalent Insider Trading Laws.' (2021) IJCLP <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3884828> accessed on 30 June 2022.

Enforcement 2020 Annual Report reflects that the efforts of the SEC in coordinating with its criminal counterparts are effective and appropriate. Moreover, the U.S. goes a step ahead of merely prohibiting insider trading and strives to curb abusive trading altogether – it takes action against manipulative trading practices which artificially boost or depress the prices of the stocks by creating a false appearance of interest for the investors. The actions of the SEC in such cases include filing emergency actions and freezing assets.[53] From charging the former finance manager at Amazon to a former IT administrator at Palo Alto Networks Inc. The SEC not only charged those involved in insider trading but also brought enforcement actions against professionals who allegedly misappropriated and traded on material non-public information. The successful prosecution of insider trading cases in the U.S. reflects that the efforts of the SEC in coordinating with its criminal counterparts are effective and appropriate. The report also highlights that to avoid insider trading cases material non-public information must be safeguarded by establishing robust corporate controls and compliance policies.[54]

Joseph G. Sansone, chief of the SEC's Market Abuse Unit, stated in an interview that with the help of "trading analysis tools", the SEC was successfully able to hold a partner at McKinsey & Company, a management consulting giant, accountable for breaching his fiduciary duties towards the company by misappropriating confidential information for personal financial gains. The convict was arrested and imposed a hefty penalty of USD 450,000.[55]

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[53] Division of Enforcement Annual Report (2020).
[54] Division of Enforcement Annual Report (2020).
[55] Press Trust of India, 'Indian-origin partner at Mckinsey arrested; charged with insider-trading' *Business Standard* (New York, 11 November 2021) <https://www.business-standard.com/article/international/indian-origin-partner-at-mckinsey-arrested-charged-with-insider-trading-121111101021_1.html> accessed on 30 June 2022.

India lacks a proper surveillance system to detect cases of insider trading early at a premature stage.[56] The existing laws lack several aspects concerning the issue, and there is a need for better precautionary measures.[57] Publicizing insider trading cases and imposing high penalties on convicts like in the USA might be helpful. The SEBI, like the SEC in the U.S., must work with other governmental agencies to investigate insider trading cases.[58] Further, the SEBI would need to adopt a gloves-off approach in imposing penalties in insider trading cases to ensure future insiders are deterred.[59] A gloves-off approach would essentially entail that the SEBI acts in an uncompromising way while dealing with insider trading cases. Imposing little amounts would not help in attaining what the SEBI has set out to achieve with the PIT regulations. There is a dearth of human resources in the SEBI, thus SEBI would also have to ensure that separate and enough authorities are assigned to deal with insider trading cases, so the cases can be completed effectively and expeditiously.[60] If wiretapping of phones and access to electronic communications is permitted to the SEBI during investigations, the risk of insider trading is likely to decrease at least in cases where the communication is happening through electronic means and not in person. Although, this power would inadvertently raise privacy concerns as it may have a negative impact on the personal liberty of individuals, however,

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[56] Pranav Saraswat, 'Elements of Effective Insider Trading Regulations: A Comparative Analysis of India and U.S.A.' [2020] NULJ 81 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3870326> accessed on 2 February 2022.

[57] Anil Kumar Manchikatla and Rajesh H. Acharya, 'Insider trading in India – regulatory enforcement' [2017] JFC 48, 54 <https://idr.nitk.ac.in/jspui/bitstream/123456789/8319/1/6.Insider%20trading%20in%20India.pdf> accessed on 2 February 2022.

[58] Rahul Mehta, 'The Redundant Nature of Prevalent Insider Trading Laws' [2021] IJCLP 1, 8 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3884828> accessed on 4 February 2022.

[59] Bhattacharya (n 24).

[60] ibid.

exceptions can be carved in high-stake cases. In the U.S., the court views large-scale insider trading cases as seriously as organized crime, extortion, and similar misconduct wherein wiretapping is more commonly used, similarly, in India, the Supreme Court must consider using wiretaps in high-stake cases so that people privy to the insider information do not make profits at the expense of those kept in the dark.[61] Furthermore, insider trading laws must be dynamic to effectively deal with future exigencies. India, like many other jurisdictions, has rejected the fiduciary model adopted in the U.S. which seems like a good decision given the ambiguous nature of the model.[62] Also, even though the SAT in the case of *Rakesh Agarwal v. SEBI*,[63] stated that laws in the U.S. and UK are not like the SEBI PIT regulations, yet, upon examining the PIT regulations carefully, various theories recognized in the U.S. can be seen incorporated in the regulations. Moreover, a small glance at the laws in the European Union, considered to be the world's first multinational insider trading regime, shows that the EU laws are more expansive than the U.S. model which requires a breach of fiduciary or other similar duty.[64] The EU extends its scope of liability beyond that of the U.S. and many other regimes across the globe. Firstly, its definition of "inside information" is broad and is defined as-

> Information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant

[61] Robert Khuzami, 'Speech by SEC Staff: Remarks at AICPA National Conference on Current SEC and PCAOB Developments' [2009] Speech – U.S. Securities and Exchange Commission <https://www.sec.gov/news/speech/2009/spch120809rsk.htm> accessed on 4 January 2023.
[62] John P. Anderson, 'Regulatory Ritualism and other Lessons from the Global Experience of Insider Trading Law' [2021] U. Penn. J. of Bus. L. 2 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3788993> accessed on 30 June 2022
[63] 1 CompLJ 193 SAT (2004).
[64] Anderson (n 62).

> effect on the prices of those financial instruments or on the price of related derivative financial instruments.[65]

And secondly, it works on a similar model to that of the "parity of information" approach that was rejected by the Supreme Court in the U*.S.* in the case of Chiarella (discussed above in para 1.2.3), and presumes the use of inside information from mere possession of information, thereby meaning that the EU picks even the individuals who simply overhear a conversation of insiders. Thus, the only requirement under the EU model is that the trader was aware while trading that he is in possession of information that is material and non-public. This model offers relative clarity and simplicity to insider trading enforcement, although at the expense of being overbroad in this seemingly streamlined approach.[66]

However, since seldom any legal system is perfect, there are certain loopholes in the laws in the U.S. as well. John P. Anderson, a legal scholar, in his paper titled 'Regulatory Ritualism and other lessons from the Global Experience of Insider Trading Law', highlighted concern with the U.S. insider trading regime. He stated how the people who claim that reform is needed in the laws, do not agree about the nature of the solution to the existing problems. [67] A few of the problems with the insider trading laws in the U.S. as highlighted by the author are that the laws are overbroad, and due to a lack of statutory definition of insider trading, there is vagueness in the law which often makes it unjust and economically inefficient.[68] Studies show that there

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[65] ibid.
[66] ibid.
[67] *Id*. at 62.
[68] John P. Anderson, 'The Ethics of Insider Trading Reform' [2018] Mercatus Working Paper, Mercatus Center at George Mason University <https://www.mercatus.org/system/files/anderson-insider-trading-mercatus-working-paper-v1.pdf> accessed on 30 June 2022.

is a need for reform in the U.S. The statutory language in the U.S. needs to be amended so there is some clarity in the laws, and so that the market participants are also certain about the laws. For instance, in a 2018 New York Times op-ed piece, Mr. Jackson, a Securities Exchange Commissioner stated that the laws in the U.S. around insider trading are outdated and unclear, and do not define "insider trading".[69] This leaves investors and defendants confused about what kind of information sharing would be permissible or what kind would be problematic. Mr. Preet Bharara, a former United States attorney, and Mr. Jackson also stated that though the U.S. Government has decided many strong insider trading cases, the laws remain somewhat ambiguous.[70] They further point out the commonly accepted idea of what constitutes insider trading i.e., trading based on material, non-public information associated with a breach of duty, but they emphasize that this can be a difficult standard to apply.[71] Some also believe that insider trading laws in the U.S. need to be liberalized so innocent persons do not get into trouble for no reason merely because of strict laws.[72] Ron Cordova, an Attorney-at-law, also expressed that the vague insider trading laws cause confusion and may at times even open the door for people to fall prey to such charges unknowingly even when they genuinely did not intend to engage in illegal activities but the ambiguous nature of the laws found them facing such charges.[73] One such instance of an unproven claim of wrongful conviction is when the Ex-Goldman Sachs director, Rajat Gupta, who was convicted of

[69] Preet Bharara and Robert J. Jackson Jr., 'Insider Trading Laws Haven't Kept Up With the Crooks' [2018] Speech - U.S. Securities and Exchange Commission <https://www.sec.gov/news/speech/jackson-insider-trading-laws-havent-kept-crooks> accessed on 4 January 2023.
[70] ibid.
[71] ibid.
[72] *Id*. at 62.
[73] Ron Cordova, 'Vague Insider Trading Laws Cause Confusion' [2019] Attorney At Law <https://www.roncordovalaw.com/blog/2019/01/vague-insider-trading-laws-cause-confusion/> accessed on 4 January 2023.

illegally sharing information about Goldman to a hedge fund manager, claimed after seven years of his conviction that he is innocent.[74] In an interview, he stated that he regrets speaking too freely about Goldman's corporate secrets and not testifying in his trials.[75] He also stated that "I was going to testify. And in the very end, they wore me down and convinced me I shouldn't. And to me, it was a personal failure".[76] Gupta was convicted because he had divulged information on a call to Rajaratnam 16 seconds right after Warren Buffet agreed to invest in the Company.[77] This is possibly only one of many such cases where an individual might have been wrongfully convicted without actually engaging in insider trading. However, lessons from the U.S. may still present a better way forward in dealing with insider trading cases in India.

V. CONCLUSION: THE WAY FORWARD

Prosecuting an insider trading case can be particularly difficult as the investigation in such cases requires obtaining information that is shared during personal communications. Investigating such personal communication would inevitably lead to the infringement of the privacy rights of an individual, meaning - too many investigative powers in the hands of authorities pose a major threat to various fundamental rights of humans. Thus, striking a balance between basic human rights and having enough powers to investigate an insider trading case is a difficult task.

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[74] Emma Newburger, 'Ex-Goldman director Rajat Gupta says he's innocent seven years after insider trading conviction' [2019] CNBC U.S. News <https://www.cnbc.com/2019/03/22/ex-goldman-director-rajat-gupta-says-hes-innocent-seven-years-after-insider-trading-conviction.htmlaccessed on 4 January 2023.
[75] ibid.
[76] ibid.
[77] ibid.

SEBI chairman, Ajay Tyagi, in his interview with Business Standard said, *"let me say among all the violations, we treat insider trading as the most serious one. It goes against the very basics of trust in the securities market*."[78] The situation in India currently regarding the prosecution of insider trading might be better handled by devoting more resources to the enforcement of policies and surveillance mechanisms, besides having robust and vigorous laws in place. Studies also show that there is a need for more manpower for the investigation and prosecution of insider trading cases in the SEBI.

Even though the statutes for insider trading in India are sufficient to deal with insider trading cases, the cases of insider trading have only been increasing year by year. This is due to the insufficient investigative tools and mechanisms to effectively prosecute a case. The loophole majorly exists at the investigation level, due to which the investigation in insider trading cases, more often than not is prolonged for an unreasonably long period. Conviction, which is the last layer in dealing with insider trading cases, is also imbued with issues as records show that SEBI imposes meagre fines which do not help in preventing insider trading. Thus, higher penalties need to be imposed to deter insiders from misusing the UPSI and protect the integrity of the market.

Moreover, some people also favor altogether deregulation of insider trading, firstly because those people believe that insider trading pushes the price of the security towards the amount that it would command if the undisclosed information was made public, thereby benefitting both, society as well as the firm through increased profits. Secondly, they believe that insider trading could be a great way to compensate the managers for producing additional value for the firm as well as society. However, deregulation is

[78] *Id*. at 45.

perceived to cause more harm than good by most lawmakers, scholars, etc. who believe that regulation protects the integrity of the market.[79]

To conclude, some of the steps that the SEBI needs to take to effectively combat insider trading in India are: (i) as a precautionary measure - strive to safeguard material non-public information, (ii) establish strict early detection mechanisms which raise alerts when there are signs of irregular trading activities, or when there is an unusual rise in the value of shares, (iii) adopt gloves-off approach and treat insider trading cases as seriously as other organised crimes – like in the case of the EU, (iv) leverage technologies like machine learning, natural language processing tools, and artificial intelligence for the purposes of surveillance, and during investigation and prosecution, i.e., upon suspecting any wrongdoing, analysing data, banking transactions, social media connections, and call records might help in building a stronger case, (v) impose hefty penalties and incarcerate the offenders for a longer period of time, lastly, (vi) publicising the alleged offenders rather than suppressing and sweeping the news under the rugs might hold back insiders in engaging in the nefarious activities of insider trading.

[79] Stephen Mark, 'The Law and Economics of Insider Trading: A Comprehensive Primer' [2001] UCLA <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=261277> accessed 30 June 2022.