

Unfair Trade Practices and Insider Trading

Introduction

The Securities market is a part of the financial market where buying and selling of securities are done. Just like any other financial market, securities market is also prone to scams, frauds and illicit activities. Securities market in India involves millions of active investors on a daily basis investing and earning money through the trade done. So it is very essential to check and prevent any of the scams or frauds in the market to safeguard the interests of all the investors in the securities market.

Owing to the growth of securities market in the Indian economy in 1992, the Government of India established a regulatory body to look after this market. It was called the Securities and Exchange Board of India (SEBI). This Securities and Exchange Board of India (SEBI) was entrusted with the following responsibilities:

1. Protecting the interests of investors in securities market.
2. Regulate the operations of the securities market.
3. Promote and develop securities market.
4. Regulate the insider trading in a company.

Fraudulent and Unfair Trade practices

As stated by SEBI in the Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market Regulations, 2003

“Fraud includes any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss”.

Prohibition of Manipulative, Fraudulent and Unfair trade practices

Securities and Exchange Board of India (SEBI) plays a pivotal and instrumental role in prohibiting any sort of activities that are manipulative or fraudulent or unfair in the securities market. After SEBI encountered many unfair practices,

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frauds that affect the securities market, SEBI passed a special regulation pertaining to prohibition of manipulative, fraudulent and unfair trade practices in chapter II (4) of 2003 regulation. The following has been mentioned:

- Nobody directly or indirectly should indulge in fraud relating to selling, buying or dealing with securities;
- No one should use any manipulative or deceptive means to violate the provisions of the Act;
- No one should employ any scheme or device or a strategy to defraud the dealings connected with securities.
- Handling with securities with a purpose of inflating or causing fluctuations in securities is not allowed instead it should be intended for transfer of ownership only.
- To pay any person money or money's equivalent for the purpose of handling securities with a motive of causing fluctuations or inflation is not allowed.
- Any act to manipulate the price of securities is not allowed.
- Use of any information that is false to make a person handle with securities is not allowed.
- To handle securities without any intention of performing or without the intention of change in ownership is not allowed.
- Should not deal with any securities that are stolen or fake.

SEBI also has certain regulations to the intermediaries such as stock brokers, sub-brokers etc. which are:

- No intermediary should promise a price to a person and if any change of price occurs later, profiting from that change occurred is not allowed.
- An Intermediary should not offer any information that is not verifiable and make a person handle securities with that unverified information.
- Should not advertise with half or partially true information that is misleading and influences a person to handle with securities.
- An intermediary handling inflated securities on behalf of a person with intent of higher brokerage is not allowed.
- No intermediary should restrain from reporting the transactions in securities that is done on a person's behalf.
- To make circular transactions that projects a fake view of buying or selling of securities in securities market is not allowed.
- No intermediary should encourage or recommend a person to handle certain securities with a motive of higher brokerage.
- No intermediary should falsify or predate any documents like contracts.

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- An intermediary should not sell or buy securities in advance knowing a future order of a company or a client, which known as the act of front-running.
- To spread fake news that induces selling or buying of securities.

Any breach to the above-mentioned statements would be considered, unlawful. If any of those breaches are done by any individual or a company it would be investigated by SEBI and appropriate actions would be taken against the party who commits such unlawful activity by SEBI.

Insider Trading

Definition: Insider trading is defined as a malpractice wherein trade of a company's securities is undertaken by people who by virtue of their work have access to the otherwise non public information which can be crucial for making investment decision.

In other words, Insider trading refers to using the unpublished information about the performance or other matters of a company, in dealings with the securities of the company.

In simple terms, it can be defined as dealing in the securities of a company on the basis of certain confidential information relating to the company which is not published or not in the public domain, i.e. unpublished price sensitive information.

The insider trading involves three basic elements:

1. There must be material non-public information.
2. This information must emanate from an inside source and must be in possession of some persons.
3. These persons shall deal in the securities based on the possessed material non- public information.

SEBI (Prohibition of Insider Trading) Regulations, 2015

The Securities and Exchange Board of India (SEBI) has notified the SEBI (Prohibition of Insider Trading) Regulations, 2015 on 15th January, 2015. These regulations are primarily aimed at preventing abuse by trading when in possession of unpublished price sensitive information and therefore, what matters is whether the person who takes trading decisions is in possession of such information rather than whether the person who has title to the trades is in such possession.

Some Important Definitions as per SEBI Regulations

Compliance Officer

“Compliance Officer” means any senior officer, designated so and reporting to the board of directors or head of the organization in case board is not there, who is financially literate and is capable of appreciating requirements for legal and regulatory compliance under these regulations and who shall be responsible for compliance of policies, procedures, maintenance of records, monitoring adherence to the rules for the preservation of unpublished price sensitive information, monitoring of trades and the implementation of the codes specified in these regulations under the overall supervision of the board of directors of the listed company or the head of an organization, as the case may be;

Connected persons / Intermediaries

Any person who is or has during the six months prior to the concerned act has been associated with a Company, directly or indirectly in any capacity including by way frequent communication with its Officers, or by being in any contractual, fiduciary or employment relationship or by being a Director, Officer or an employee of the Company or holds any position including a professional or business relationship between himself and the Company whether temporary or permanent that allows such person, to access the UPSI for some legitimate purposes. Connected persons / Intermediaries would include:

- a. An immediate relative of connected / Intermediaries person
- b. A holding Company or associate company or subsidiary company or
- c. An intermediary or an employee or Director thereof;
- d. An investment Company, trustee Company, asset management Company or an employee or Directors thereof;
- e. An official of a stock exchange or of clearing house or corporation; or
- f. A member of Board of trustees of a mutual fund or a member of the board of Directors of asset management Company of a mutual fund or is an employee thereof;
- g. A member of the Board of Directors or an employee, of a public financial institution as defined under the Companies Act, 2013.
- h. An official or an employee of a self-regulatory organization recognized or authorized by the Board; or
- i. A banker of the Company; or
- j. A concern, firm, trust, Hindu undivided family, Company or association of persons wherein a Director of a Company or his immediate relative or banker of the Company, has more than ten per cent of the holding or interest.

All the above said designated persons / connected persons shall sign a confidentiality agreement with the Company to maintain the confidentiality of the unpublished price sensitive information which they may get to know on a need to know or legitimate purpose basis.

Insider

Insider is person who is

- a connected person; or
- in possession of or having access to such unpublished price sensitive information.

Unpublished Price Sensitive Information (UPSI)

Unpublished Price Sensitive information means any information, relating to a Company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following:

- Financial Results
- Dividends
- Change in capital structure,
- Mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions;
- Changes in key managerial personnel, etc.
- Any material event in accordance with the listing agreement.
- Any other information, which is likely (if published) to materially affect the price of the securities of the Company. Any information which is not generally available would be UPSI that is likely to materially affect the price upon coming into the public domain.

Prohibition on Communicating or Procuring UPSI

An Insider shall not –

- Communicate, provide, or allow access to any UPSI, relating to the company or its securities, to any person including other insiders, except to the extent allowed by these rules;
- Procure from or cause the communication by an insider of UPSI, relating to the company or its securities;

Provided that nothing contained above shall be applicable when an UPSI is communicated, provided, allowed access to or procured:

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- In furtherance of legitimate purposes, performance of duties or discharge of legal obligations pursuant to appropriate confidentiality and non-disclosure agreements being executed; or
- In the event the board of directors direct or cause the public disclosure of UPSI in the best interest of the company; or
- Within a group of persons if such persons have been identified and secluded within a “chinese wall*” or information barrier by the compliance officer from the rest of the company for a particular purpose or for a specified period of time in furtherance of legitimate purposes, performance of duties or discharge of legal obligations, and are subjected to, among other conditions, additional confidentiality obligations, information barriers designed to prevent exchanges of UPSI outside the “chinese wall”, and the execution of an undertaking by such persons to abstain and / or forego trading during such seclusion or till the UPSI no longer constitutes UPSI.

* **Chinese Wall**” means the limit up to which information may be revealed by an Insider in furtherance of the Insider’s legitimate purposes, performance of duties or discharge of his legal obligations.

Principles for Fair Disclosure of Unpublished Price Sensitive Information

- Prompt public disclosure of unpublished price sensitive information that would impact price discovery no sooner than credible and concrete information comes into being in order to make such information generally available.
- Uniform and universal dissemination of unpublished price sensitive information to avoid selective disclosure.
- Designation of a senior officer as a chief investor relations officer to deal with dissemination of information and disclosure of unpublished price sensitive information.
- Prompt dissemination of unpublished price sensitive information that gets disclosed selectively, inadvertently or otherwise to make such information generally available.
- Appropriate and fair response to queries on news reports and requests for verification of market rumours by regulatory authorities.
- Ensuring that information shared with analysts and research personnel is not unpublished price sensitive information.
- Developing best practices to make transcripts or records of proceedings of meetings with analysts and other investor relations conferences on the official website to ensure official confirmation and documentation of disclosures made.
- Handling of all unpublished price sensitive information on a need-to-know basis.

Penalty for Insider Trading

- As per the section 15G and 24 of the SEBI Act, insider, who violate the 2015 regulations, are liable to a penalty that may be imposed by SEBI of Rs.25 crores or 3 times the amount of profit made out of the insider trading, whichever is higher and shall also punishable with imprisonment for a term extending to 10 years or a fine up to 25 crores or both.
- As per section 11(c) (6) of the SEBI act, if any person without justifiable reason, refuse to co-operate in any investigation by SEBI with respect to insider trading, then he shall be punishable with an imprisonment for a term extending up to one year, or with fine up to Rs. 1 crore or with both, and also with further fine up to Rs. 5 lakh for every day of such non co-operation.
- As per section 11(4) (b) of SEBI act, SEBI is also empowered to pass directions to such insider not to deal in the concerned securities in any particular manner and/or prohibit him from disposing of the concerned securities and /or declaring the concerned transaction(s) of securities as null and void, restraining the insider from communicating or counselling any person to deal in securities.
- As per section 195 of the Companies Act, 2013 any insider contravenes the provisions of this section, he/she shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five lakhs rupees but which may extend to twenty five crore rupees or three time the amount of profits made out of insider trading, whichever is higher, or with both.