AIJRRLSJM VOLUME 1, ISSUE 1 (2017, JAN) (ISSN-2455-6602) ONLINE
ANVESHANA'S INTERNATIONAL JOURNAL OF RESEARCH IN REGIONAL STUDIES. LAW, SOCIAL SCIENCES, JOURNALISM AND MANAGEMENT PRACTICES

INSIDER TRADING AND ISSUES

M.Sudha Madhavi
I/C Principal & Associate Professor
Saanvi P.G. College for Women
Hyderabad-500058
Email : smakella@gmail.com

ABSTRACT

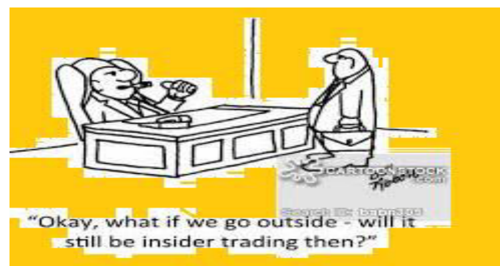
Insider means any person who, is or was connected with the Company or is deemed to have been connected with the Company, and who is reasonably expected to have access to unpublished Price Sensitive Information in respect of Securities of the Company, or who has received or has had access to such unpublished Price Sensitive information. Insider trading means dealing in Securities of a company by its Directors, Employees or other Insiders based on unpublished Price Sensitive Information. Such dealings by Insiders erode the investors' confidence in the integrity of the management and are unhealthy for the capital markets. Section 2(1)(g), Securities and Exchange Board of India ("SEBI") (Prohibition of Insider Trading) Regulations of 2015, Insider is defined as "any person who is: i) a connected person; or ii) in possession of or having access to unpublished price sensitive information". In most of the business situations these days insiders earn profits from stock trading this does not surprise most financial economists, but these outsiders can earn abnormal returns by using publicly available insider trading data constitutes a serious exception to stock market efficiency. This paper conceptually attempts to identify rules, amendments and cases pertaining to insider trading and its issues. The information is collected from the secondary sources.

Keywords: Insider trading, misleading, business, regulations, laws

INTRODUCTION

Insiders—a firm's principal owners, directors, and management, as well as its lawyers, accountants, and similar fiduciaries—routinely possess information that is unavailable to the general public. Because some of that information will affect the prices of the firm's securities when it becomes public, insiders can profit by buying or selling in advance. Even before the thirties, insiders were liable under the common law if they fraudulently misled uninformed traders into accepting inappropriate prices. But the Securities Exchange Act of 1934 went further forbidding insiders from even profiting passively from superior information.

(1) No insider shall communicate, provide, or allow access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, to any person including other insiders except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.



Source: cartoonslock.com

Insider trading undermines public confidence in the securities markets. If people fear that insiders will regularly profit at their expense, they will not be nearly as willing to invest. A similar argument is that companies prefer that their securities trade in "thick" markets—that is, markets with many traders, substantial capital available, and frequent opportunities to trade at readily observable prices. Efficient securities markets, it is argued, require a "level informational playing field" to avoid frightening away speculators, who contribute to securities market liquidity, and investors, who could invest their savings in markets with less risk of insider predation. Working on such a premise, over the last quarter-century the SEC has brought new and ever more stringent enforcement initiatives against insider trading.

Stakeholders and firm specific investment play different roles in different businesses and different companies have different strategies concerning their input providers. Silicon Valley high tech companies where employee human capital matters a lot provided stock options to employees deeply into the organization.

The Prohibition of Insider Trading regulations of 1992 seemed to be more corrective in nature. The 2002 amendment regulations on the other hand are preventive in nature. The amendment requires all the listed companies, market intermediaries and advisers to follow the new regulations and also take steps in advance to prevent the practice of insider trading. The new regulations include mandatory disclosures by the Directors and other officers of listed companies and also by the persons holding more than 5% of the company's shares. Insider trading practice is also required to be curbed during important announcements of the company. These preventive measures ensure the reduction of the cases involving the practice of Insider Trading and also informing the persons who indulge in such practices, of the laws relating to Insider Trading. The new regulations particularly emphasize on the delegation of powers on the entities themselves to conduct internal investigations before they present their case before the SEBI in relation to insider trading. The guidelines provide for a definite set of procedures and code of conduct for the entities whose employees, directors and owners are most expected to be in a position to take an undue advantage of confidential inside information for their personal profits.

NEWS UPDATES

The 2015 law and Sodhi panel say that no insider shall communicate, provide or allow access to any unpublished price sensitive information relating to a company or securities listed or proposed to be listed to any person including other insiders except where such communication is in furtherance of legitimate purpose or performance of duties or discharge of legal duties.

Markets regulator SEBI today ordered impounding of alleged illegal gains worth over Rs 1.44 crore from Abhijit Rajan, former CMD of Gammon Infrastructure Projects and three other entities in an insider trading case.

The other three entities are Consolidated Infrastructure Company and its directors -- Indru B Hingorani and Kiran Indru Hingorani.

SEBI is looking into social media such as FB and twitter of suspected persons "with mutual funds on face book" are being cited as evidence for the first time in an insider trading case. The regulators are using social media accounts as an evidence for proving charges against individual. SEBI has ordered impounding of unlawful gains of over 2 crores from individuals. A probe has been conducted by SEBI in the share price of M/s. Palred technologies between sep2012-Nov2013 revealed that the entities has been traded in the shares of the company on the basis of unpublished price sensitive information (UPSI) pertaining to slump sale of its software solutions business and declaration of interim dividend and made profits to the tune of 1.66 crores, by indulging in these activities these persons have violated the regulator's Prohibition of Insider Trading norms. Accordingly the watchdog has ordered impounding of the alleged unlawful gains of sum of Rs: 222, 14,383(Including interest) from the date of buy transactions to Jan-31 2016 jointly and severally from the persons.

REVIEW OF LITERATURE

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 decisions. When insiders, e.g. key employees or executives who have access to the strategic information about the company, use the same for trading in the company's stocks or securities, it is called insider trading and is highly discouraged by the Securities and Exchange Board of India to promote fair trading in the market for the benefit of the common investor.

Fernandes and Ferreira (2006) mentioned that the likely existence of some insider trading emphasizes the importance of strong and clear insider trading laws. Treating insider trading as a criminal offence, with the possibility of suspected persons being subject to investigation and criminal proceedings, may act as a strong deterrent to some persons, although it is unrealistic to expect full compliance with any law.

Bhattacharya and Daouk (2002) find that the cost of equity declines after the first prosecution of insider trading. This is consistent with the notion that outside investors are aware of the existence of private information trading by insiders and take account the resulting adverse selection when calculating expected returns.

Pratt and DeVere (1970) Jaffe (1974), and Finnerty (1976) among others, conclude that insiders earn significant abnormal profits by trading the securities of their own firms.'

The 2015 Regulations have likewise struck a harmony between the restriction of and the requirement to disclose insider information for legitimate reasons, for example, for mergers and due diligence of the issues of organizations.

Restrictions on Communication and Trading by Insiders

(1) No insider shall communicate, provide, or allow access to any unpublished price sensitive information, relating to the Company or securities listed or proposed to be listed, to any person including other insiders except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations;
(2) No person shall procure from or cause the communication by any insider of unpublished price sensitive information, relating to a Company or securities listed or proposed to be listed, except in furtherance of legitimate purposes, performance of duties or discharge of legal obligations;
(3) Notwithstanding anything contained in this Code, unpublished price sensitive information may be communicated, provided, allowed access to or procured, in connection with a transaction that would:
(i) Entail an obligation to make an open offer under the takeover regulations where the Board of Directors of the Company is of informed opinion that the proposed transaction is in the best interests of the Company;
(ii) not attract the obligation to make an open offer under the takeover regulations but where the Board of Directors of the Company is of informed opinion that the proposed transaction is in the best interests of the Company and the information that constitute unpublished price sensitive information is disseminated to be made generally available at least two trading days prior to the proposed transaction being effected in such form as the Board of Directors may determine; However, the Board of Directors shall require the parties to execute agreements to contract confidentiality and non-disclosure obligations on the part of such parties and such parties shall keep information so received confidential, except for the limited purpose of Clause 4(3) and shall not otherwise trade in securities of the Company when in possession of unpublished price sensitive information.

Misappropriation of information involves a person (the user) trading while in possession of confidential price-sensitive information that belongs to some other entity to which the user owes a fiduciary duty (the owner). This misuse of proprietary rights over information may also detrimentally affect the commercial reputation of the owner of the information and the value of its securities.
(In some instances, the inside information may be deliberately withheld from that entity. For instance, a prospective bidder company would be the owner of any confidential information that it intends to conduct a takeover bid for a target company. The misappropriation rationale would therefore extend to an officer of a prospective bidder company who traded in target company shares). There is also a significant disparity in the way in which it is felt that the Insider trading should be regulated. This is reflected in somewhat innovative manner that

regulators in different countries have approached the issue. The end product may be explained in relation to the application of a function of three main theoretical foundations that provide the legal basis of regulating Insider trading, namely;

1. Misappropriation Theory: Misappropriation of corporate information for personal gains or benefits.
2. Unfair Advantage Theory: The unfair advantage that the Insider has over the other investor or transacting party.
3. Market Stability Theory: The adverse effect that insider trading may have on the stability of the market in terms of transparency and efficiency

Market fairness: This act is a proposed legislation pending in the United States Congress that would enable state governments to collect sales taxes and use taxes from remote retailers with no physical presence in their state

Case

One of the most famous instances of insider trading was Charles F. Fogarty's purchase of Texas Gulf Sulphur shares during 1963 and 1964. Fogarty, an executive vice president of Texas Gulf, knew that the company had discovered a rich mineral lode in Ontario that it could not publicize before concluding leases for mineral rights. In the meantime Fogarty purchased 3,100 Texas Gulf shares and earned $125,000 to $150,000 (in 1991 dollars).

At Smith Barney Shearson Inc., mutual-fund managers and brokers are barred from making a short-term profit on personal investments: They can't buy and sell the same stock within a two-month period. But many other firms impose no such restriction.

CONCLUSIONS

- If expropriation by insiders destroys corporate value, we expect a reduction in firm value for high-wedge firms when insider trading regulation is stringent Most of the times firms are valued lower in lax insider trading regimes. As expected, firm value is lower when agency costs, as measured by the ownership wedge, are higher. These companies are valued even lower in strict insider trading regulation countries.

- By comparing stock price informativeness before and after the first enforcement of insider trading laws that is, insider trading laws are less effective in developing countries where agency costs are higher.

- Many people think of values as soft; to some they are usually unspoken. A South Seas island society uses the word *mokita*, which means, "The truth that everybody knows but nobody speaks.

- European rules tackle the issue of insider trading more explicitly and directly therefore resulting in a clearer, systematic and straightforward approach if the same is adopted by the Indian rules it would be more appropriate.

REFERENCES

1. Bhattacharya, U., Daouk, H., Welker, M., 2003. The world price of earnings opacity. Accounting Review 78, 641–678
2. Fernandes, N., Ferreira, M., 2006. Insider Trading Laws and Stock Price Informativeness, Working paper, CEMAF/ ISCTE
3. Code of conduct for prevention of insider trading, mcxindia.com
4. The Economic Times, (12/12/2013), http://articles.economictimes.indiatimes.com/2013-12-12 Carlton, Dennis W., and Daniel R. Fischel. "The Regulation of Insider Trading" Stanford Law Review 35 (1983): 857-95.
5. Pratt. S.P. and C.W. DeVere, 1970, Relationship between insider trading and rates of return for NYSE common stocks, 1960-1966, in: J. Lorie and R. Brealey, eds., Modem developments in investment management (Praeger, New York).
6. The Economic Times Daily-2016