

Insider Trading: An Illicit Trading

Use of Information Technology and recent case laws

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Coverage

- ❑ Understanding Insider Trading
 - Brief overview
 - Regulatory aspects
 - Difference between Insider, DP and CP

- ❑ Use of Information Technology for detecting Insider trading
 - Use of IT tools by SEBI
 - Insider trading cases globally
 - Recommendations for companies

- ❑ Case laws

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Insider Trading means trading or dealing in securities of a listed entity directly or indirectly by an insider based on some unpublished price sensitive information (UPSI)

“Insider” means any person who is:

- a. *Connected person (refer slide 7)*
- b. *In possession of or having access to unpublished price sensitive information*

Therefore, any person in possession of UPSI shall be regarded as an insider regardless of how the person has obtained such information.

“Trading” means and includes:

subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities, and "trade" shall be construed accordingly

The intent is to curb the activities persuaded by UPSI, though not strictly covered in buying or selling. For example pledging of securities.

“Securities” includes:

- shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of any body corporate
- Derivatives
- Units of any CIS
- Security receipts
- Government securities
- Any other instrument as may be declared by Central Government

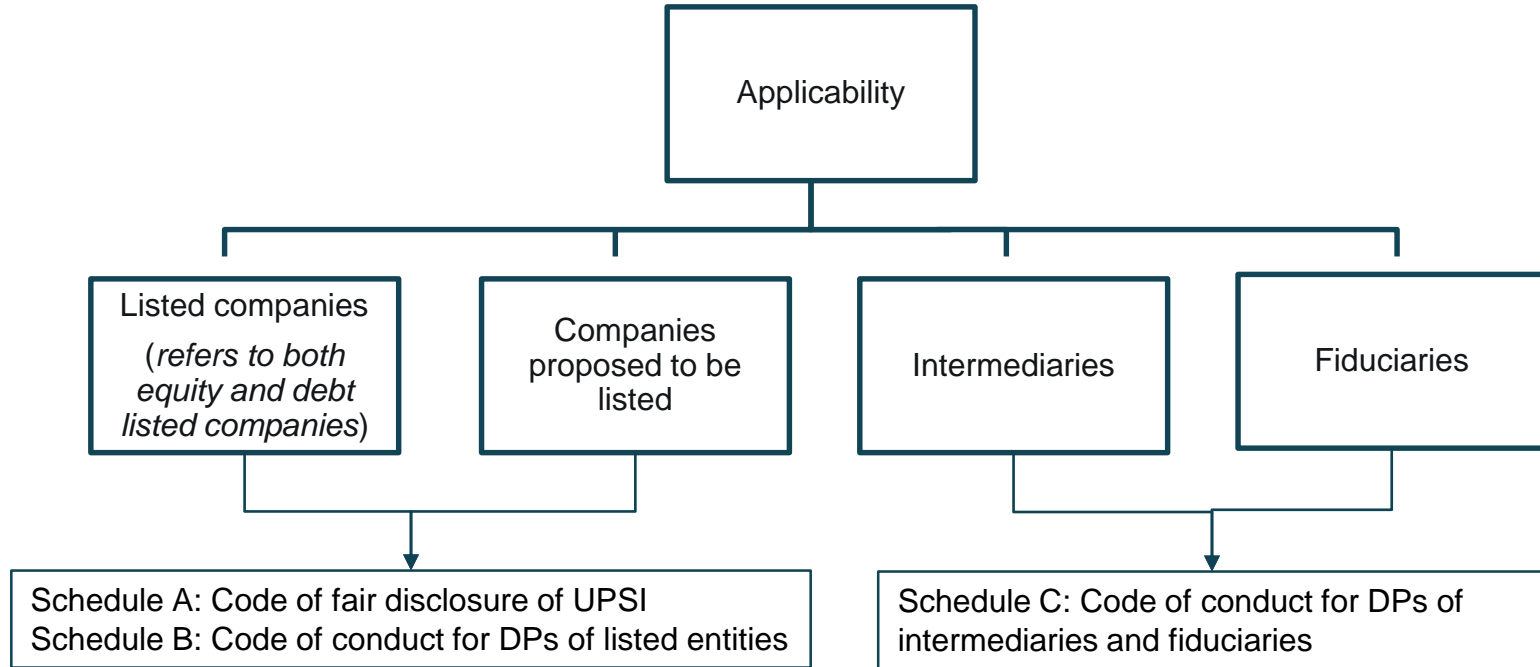
“UPSI” means:

Any information directly or indirectly relating to the securities of the company which is not available in public domain, however, on publishing can materially affect the prices of the securities.

For example: financial results of the company, changes in KMP, corporate actions like merger, de-merger, buyback, acquisition, delisting, etc.

Regulatory Provisions

SEBI (Prohibition of Insider Trading) Regulations, 2015



Obligations of Insider

- No Insider shall communicate or allow access to any UPSI relating to the company to any person;
- No person shall procure from or cause the communication of UPSI by any insider;
- Insider shall handle UPSI on 'need to know basis';
- Share UPSI only for legitimate purpose, performance of duties or discharge of legal obligations;
- Insider shall not trade in securities of the Company while in possession of UPSI;
- Needs to comply with code of conduct, as may be applicable.

Who is a Connected Person?

Connected Person means:

- ❑ Any person who is or has been during the 6 months prior to the concerned act associated with the company
- ❑ Directly or indirectly, in any capacity
- ❑ Including by reason of:
 - frequent communication with its officers;
 - contractual, fiduciary or employment relationship;
 - being a director, officer or an employee of the company;
 - professional or business relationship between himself and the company.
- ❑ that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access.

Deemed Connected Person

Following shall be deemed to be connected persons unless the contrary is established:

- Immediate relative of connected persons;
- a holding company or associate company or subsidiary company;
- an intermediary u/s 12 of SEBI Act, its employee or director thereof;
- an investment company, trustee company, AMC, its employee or director thereof;
- an official of a stock exchange;
- a member of board of trustees of a mutual fund or a member of the BOD of the asset management company of a mutual fund or is an employee thereof;
- a member of the BOD or an employee, of a public financial institution
- an official or an employee of a self-regulatory organization recognised or authorized by the SEBI;
- a banker of the company;
- a concern, firm, trust, HUF, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than 10% of the holding or interest.

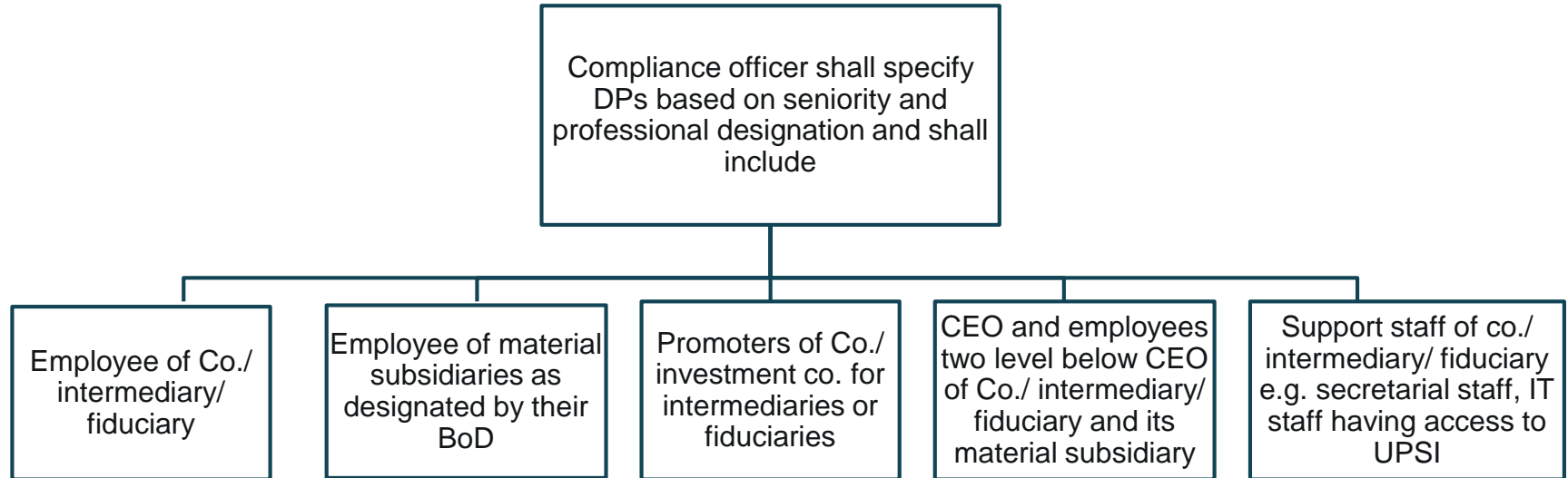
Onus of proof

Connected person includes any such person who would have access to or could have access UPSI by virtue of any connections with company.

Immediate relatives and other categories of persons specified above are also presumed to be connected persons unless proven otherwise.

In case of connected person the onus of establishing that the person was not in possession of UPSI, shall be on the connected person himself. However, in other cases, the onus shall be on SEBI.

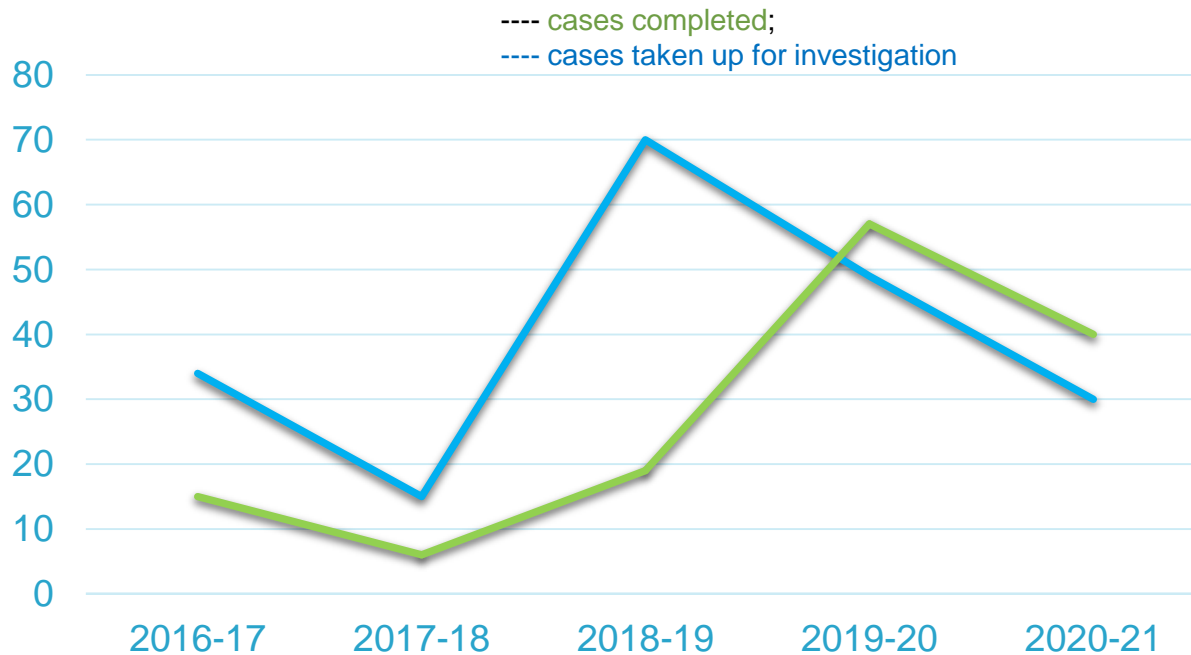
Who is Designated Person?



Obligations of DPs

- ❑ Disclosure Requirements:
 - Initial disclosures on holding of securities [Regulation 7(1)]
 - Continual disclosures [Regulation 7(2)]
 - Annual disclosures of personal details of DP
- ❑ Compliance with Code of Conduct of the company
- ❑ Prohibition on trading during trading window closure
- ❑ Obtaining pre-clearance from the compliance officer before trade during permitted period
- ❑ No contra trade for 6 months

Statistics of Insider Trading cases



Source:
https://www.sebi.gov.in/reports-and-statistics/publications/aug-2021/annual-report-2020-21_51610.html

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- ❑ Use of information Technology tools and techniques for prohibition of Insider Trading

Use of IT by SEBI (1/2)

- ❑ Information Technology is acting like a double-edged sword;
- ❑ SEBI surveillance mechanism has become almost 100 times more effective with the use of latest technologies;
- ❑ Earlier insider trading alert has been replaced by a new one which utilises trade data as inputs and generates an alert in case of any abnormal fluctuations in the trading pattern of scrips of any company;
- ❑ The alert builds up a suspect library which helps in identifying repeated offenders;

Use of IT by SEBI (2/2)

- ❑ SEBI has identified a series of technology driven initiatives including algorithms, artificial intelligence, etc to detect cases of malpractices;
- ❑ SEBI is also considering effective implementation of Artificial Intelligence on its platform;
- ❑ Office of Informant Protection was established in January, 2020 for receiving and processing information pertaining to violation of insider trading provisions submitted through Voluntary Information Disclosure Form (VID form).

Source:

https://www.sebi.gov.in/reports-and-statistics/publications/aug-2021/annual-report-2020-21_51610.html

Cases of Insider Trading in USA

- ❑ Corporate Insider Brothers: US SEC charged two brothers with insider trading in the securities of the Company in which they served as the Chairman and Vice Chairman of the Board. Through their positions on the Board, they knew that the Company had decided to put itself up for sale. Based on this material non-public information, they made a large and bullish transaction in the Company's securities that yielded over \$31 million in illicit profits.
- ❑ Two traders in Chile: SEC charged two business associates in Chile with insider trading based on non-public information that one of them learned while serving on the board of directors of a pharmaceutical company. They reaped approximately \$10.6 million in illicit profits

Insider Trading in UK

- ❑ **Financial Conduct Authority (FCA)** the financial regulatory body in UK focuses on use of innovative technologies to regulate financial market;
- ❑ To deliver digital services and products, it is migrating to cloud based services;
- ❑ Development of data lake, a central data store for all FCA data;
- ❑ Insider dealing case: FCA sentenced two person imprisonment of three years' in respect of five offences of insider dealing. One of them made an illicit profit of approximately £1.4 million from such trading.

Source:

<https://www.fca.org.uk/publications/corporate-documents/data-strategy-update-2022#lf-chapter-id-introduction>

Recommendations for companies (1/2)

- ❑ Since the regulators are becoming more and more concerned about Insider Trading, there is a need for the companies to use advanced technology solutions to protect themselves.
- ❑ The role of technology department within an organisation should be enhanced to continuously monitor the cases of insider trading.
- ❑ Employees must be made aware of consequences of communicating, sharing or trading on the basis of inside information of the organisation.
- ❑ Any communication or sharing of UPSI within or outside the organisation to be recorded appropriately in Structured Digital Database (SDD) maintained by the company.

Recommendations for companies (2/2)

- ❑ The organisations must have surveillance mechanism in place for monitoring the corporate devices used by the employees.
- ❑ Any communication of inside information or trading in securities may be tracked by the Internet Protocol (IP) address of the device used by the employee for such a violation.
- ❑ No inside information to be communicated to the outsiders during informal or social gatherings.
- ❑ Adequate disclosures w.r.t demat holding of the employees must be observed by the organisation.
- ❑ Insider trading to be clearly communicated within an organisation and strict actions to be taken in case of any violation.

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Case Laws

Case No. 1

Facts of the case:

- UPSI pertained to financial statements of the Company
- ABC Ltd. and AXY Ltd. traded in shares of the Company.
- Mr. P, an employee (DP) of the Company was connected with Mr. A, partner in ABC Ltd via telephonic conversations during the period of UPSI and trading period as per the records of SEBI.
- Further, transfer of funds have been made by them in name of mutually owned (through relatives) private company.
- Mr. A was connected with Mr. B, partner in the same firm on account of his professional relation as well as by telephonic communications.
- Also, Mr. A was partner in AXY Ltd.

ABC Ltd. and AXY Ltd. traded in shares of the Company prior to the announcement of financial results and squared off the position post announcement, thereby, showing net position as zero.

By such transaction, ABC Ltd. generated proceeds of around 280 lakhs followed by AXY Ltd. of 27 lakhs.

Since they were connected with one another in some or the other way and has procured UPSI in some form and manner, SEBI held them guilty of insider trading and imposed penalty accordingly. The entities were further restrained from buying, selling or dealing in securities market till further orders.

Case No. 2

- An employee of the Company traded in shares of the Company complying with the provisions of PIT Regulations.
- However, the disclosures pursuant to regulation 7(2)(a) was delayed by 4 days
- The accused contended of not being aware of law and had no gain out of such delay.

- SEBI imposed penalty of Rs. 2,00,000 on account of delay in making disclosures.
- In case of *SEBI v. Shriram Mutual Fund and Anr*, fine was levied immediately on account of default whether made intentionally or not.
- In *Gaylord Commercial Company Limited v. SEBI*, it was held that penalty u/s 15A(b) shall be applicable on account of delay in making disclosures even when there is no gain or loss.

Takeaway: Penalty shall be levied for violation of insider trading provisions even when made unintentionally.

Case No. 3

- This case involves circulation of UPSI pertaining to financial statements of various companies by one of the employees of stock broking company through several WhatsApp groups.
- SEBI directed search and seizure and confiscated various documents and devices, imposing fines accordingly.

The accused contended the concept of “Heard on Street” (“HOS”) which is a common practice among traders, market analysts, institutional investors etc.

- Since SEBI could not find the origin of messages, “forwarded as received” WhatsApp messages pertaining to UPSI was set aside by SAT.
- The person just forwarding the message cannot be considered as insider.
- Information may be regarded as UPSI only if the person receiving it was aware that it was a UPSI.

Case No. 4

- SEBI suspected Insider Trading in scrips of the Company.
- Promoters shareholding was reduced by 20% while in possession of UPSI.
- SEBI imposed penalty for violation of provisions of Insider Trading.

SAT set aside the order of SEBI, stating that since the entire sale proceeds was infused in the business only, proviso to regulation 4 which provides for an inclusive list to prove his innocence shall apply.

Provision of law:

Proviso to regulation 4(1) : Trading may be done while in possession of UPSI provided the insider is able to prove his innocence including but not limited to the circumstances as specified.

Case No. 5

- The Company proposed to sell shares of its subsidiary to a third party.
- Board and shareholders resolution for the same was passed by the Company.
- Post this, Mr. X became member of managing committee of the Company that was authorized to approval such a transaction.

Mr. X traded in shares of the Company during the UPSI period.

SEBI held him guilty of insider trading and imposed penalty.

SAT quashed the order of SEBI stating that approval of such a transaction was made prior to his joining the Company. Further, he was not in possession of UPSI while trading in the securities.

Also, it was observed that such an information was already available in public domain and was not to be considered as UPSI.

Thank You