Chapter 4
Insider Trading:
A South Asian Study

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ABSTRACT
This chapter studies the international market malpractice of insider trading where officials holding a fiduciary duty towards the company, violate the same to utilise company specific and price sensitive information to trade in company securities before such information is announced to the public investors. Information asymmetry, gross violation of ethical standards and abuse of fairness and market integrity are the underlining terms of this offence. The chapter studies four SAARC nations of India, Pakistan, Sri Lanka and Nepal to project their working against insider trading. While countries introduce law and yet fail to enforce it, SAARC countries are encouraged through this chapter to maintain strong ground against this malady. The author projects recommendations and observations to prompt periodic statutory review.

INTRODUCTION
The author will be dividing the chapter into three parts – Part I, II & III respectively. Part I shall give the readers a brief background of the insider trading activity, its accepted definition and the development of this malady. Part II shall provide a synthesis of the insider trading regulations and enforcement procedures existing in the South Asian countries of India, Pakistan, Sri Lanka and Nepal. Part III shall offer the author’s observations and recommendations to each nation on curbing this wide spread practice.

INSIDER TRADING AND ITS DYNAMICS
Regulation for insider trading is a recent phenomenon. The first country to enact insider trading law was United States of America, the inspiration of which was the Securities Act of 1934 which prohibited other kinds of stock manipulation (Barnardo, 2001). France was the second country followed by UK, Japan, Australia and Korea. 1989, EU passed a Directive requiring all member countries to pass legislation

DOI: 10.4018/978-1-5225-0004-9.ch004
Insider Trading

prohibiting insider trading (Gevurtz, 2002). By 1991, Sri Lanka was the first SAARC Nation to amend its securities Act of 1987 to include insider trading prohibitive sections (Akhter & Ghani, 2010). Thus, the author points out that SAARC has been behind in the regulatory race to snatch and kill the offensive practice. This chapter shall individually study each country’s regulatory activities and bring out the stand taken on insider trading. Before that, a general background and reading on the concept of insider trading and the need of prohibition is advised.

In simple words, insider trading is the illegal trading in the shares of a company whilst in the possession of unpublished, price sensitive information in respect of the securities of the said Company, with a view to the making of a profit, or the avoidance of a loss. As Lord Lane puts it: “the rationale behind the prohibition on insider trading is “the obvious and understandable concern about the damage to public confidence which insider dealing is likely to cause and the clear intention to prevent so far as possible what amounts to cheating when those with inside knowledge use that knowledge to make profit in their dealings with others.”

Under insider trading, the restriction is on corporate insiders directly or indirectly using the price sensitive information that they hold to the exclusion of the other shareholders in arriving at trading decisions. Such illegal insider trading undermines investor confidence in the fairness and integrity of the financial markets. This accounts for the reason why nearly every jurisdiction has strictly prohibited this activity.

It has been observed that insider trading is an evocative subject. Drafting regulations for this practice, in precise and unambiguous terms entails balancing multiple and conflicting perceptions of various stakeholders in the market system. For example, the High Level Committee under the chairmanship of Justice N.K. Sodhi set up in India to suggest insider trading regulatory reforms held a view that ideally, the easiest but most simplistic approach would be to prohibit any trading by an insider (SEBI, 2013). However, such an approach would not only be as ineffective as any blanket prohibition policy but would also be unrealistic and out of sync with economic and regulatory realities.

The general offence of insider trading requires the fulfilment of the following components:

1. The person responsible for committing the offence must be an insider;
2. The insider must hold material unpublished price sensitive information;
3. The insider must use this knowledge to trade in the company’s securities;
4. The insider must consequently, earn profits at the expense of the public investors.

The materiality of a fact depends upon the circumstances. A fact is considered “material” if there is a substantial likelihood that a reasonable investor would consider it important in making a decision to buy, sell or hold a security or where the fact is likely to have a significant effect on the market price of the security. Material information can be positive or negative and can relate to virtually any aspect of a company’s business or to any type of security – debt or equity.

Information is “unpublished price sensitive information” if it is not available to the general public and it could potentially have any effect on the price of the Company securities. In order for information to be considered public, it must be widely disseminated in a manner making it generally available to investors through such media as the website of the Stock Exchange, newspapers or other media outlets. The circulation of rumors, even if accurate and reported in the media, does not constitute effective public dissemination.
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