

INTRODUCTION OF INFORMANT MECHANISM INTO INSIDER TRADING REGULATIONS OF INDIA: A CRITICAL ANALYSIS

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ABSTRACT

The Securities and Exchange Board of India (SEBI) has consistently been laden with the laborious errand of controlling insider trading yet the trouble in distinguishing and indicting the culprits despite everything stays a test. This is principally because of the way that there is a shortage of securing essential proof which can prove the complicity of ones who commit insider trading along these lines which consequently affects the success rates and investigation periods of such cases. SEBI has attempted to dispose of this hassle or hindrance in the past by looking for forces to intercept and tap phone calls to help it's investigation and surveillance machinery. Besides, it has likewise tried to give immunity to informants or give a lesser punishment on the individuals who approach with full and genuine divulgence of the alleged violations. Be that as it may, these measures have either not come around or their undeniable execution is as of now an implausible idea.

The proposed mechanism will have a committed reporting window and furthermore looks to accomplish close to total secrecy with respect to the identity of the informants so as to reduce any sort of deterrence stemming out from dread of discrimination, retaliation and prejudice. This mechanism is anything but a sui generis wonder, as is obvious from the successful use of comparable systems adopted by different nations to address the issue of insider trading. The European Union (EU) Market Abuse Regulation accommodates a reporting mechanism on similar lines. The proposed mechanism is fairly like the vigil instrument endorsed under Section 177(9) of the Companies Act, 2013.

ANALYSIS OF INTRODUCTION OF INFORMANT MECHANISM INTO INSIDER TRADING REGULATIONS OF INDIA

The Security Exchange Board of India (SEBI) had formulated a discussion paper before the amendment of informant mechanism came into being in August 2019. Prosecuting insider trading cases has consistently been a test for the Securities Exchange Board of India (SEBI) since essential proof is hard to get a hold of, which impacts success rates as well as investigation timelines.

On June 10, 2019, SEBI discharged a discussion paper proposing amendments to the SEBI (Prohibition of Insider Trading) Regulations, 2015 (Insider Trading Regulations) to build up frameworks and procedures both inside listed companies and intermediaries. SEBI has incentivized people to report insider trading violations, if it comes to their knowledge.ⁱ As far as the Discussion Paper is concerned, the informant might be rewarded up to INR 1 crore (approx. USD 150,000) if SEBI undertakes disgorgement of at least INR 5 crores (approx. USD 0.72 million) because of any action made based on true, credible and original information.

The informant mechanism is proposed to be executed through amendments to the Prohibition of Insider Trading Regulations, 2015. A portion of its key highlights are as per the following:

- ❖ Any person who has information or sensible premise to believe that an insider trading violation has or is going to happen, regardless of whether through exchanging or correspondence, can willfully inform SEBI through the Voluntary Information Disclosure Form (VIDF). The witness should likewise give the source of the information.
- ❖ The Discussion Paper additionally conceives submission of information anonymously, acting through an advocate. In such cases, the delegated advocate would likewise need to stick to specific obligations with regard to the informant, such as verification of their identity and maintaining confidentiality.
- ❖ The Office of Informant Protection (OIP), would be set up as an autonomous wing which is discrete from SEBI's investigation and assessment wings, to go about as the contact with the informant. The OIP would be answerable for setting up an approach for handling the Form, including an instrument to evaluate the veracity of the information received.ⁱⁱ

- ❖ Once the information is handled by the OIP, it would be moved to the relevant department, which would prescribe appropriate enforcement action. In this manner, the OIP would likewise settle on a choice with respect to grant of reward to the informant upon completion of enforcement activity by SEBI.
- ❖ Under the system, the identity of the informant as well as information provided would be kept classified by the OIP, including through any procedures started by SEBI, aside from situations where the identity of the informant is required to be depended on.
- ❖ Listed companies, intermediaries, and so forth., would be required to update their inward codes to guarantee that representatives of the company are not punished only on account of filling a Form or helping SEBI.
- ❖ An absolution plan may likewise be offered to informants confronting enforcement action activity, where they decide to co-operate with the regulatory investigation

Prima facie, this Discussion Paper draws heavily from the US Security Exchange Commission's (SEC) informant mechanism structure, standardized under the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, and its three pillars of whistleblower protection policy viz., anonymity, bounties and job protection.ⁱⁱⁱ

While the whistleblower mechanism has been successful in the US, reproducing the model for the Indian market, however well – intentioned, may not be a guarantee for success. Some of the worries that could emerge have been talked about underneath :

- ❖ The Discussion Paper, as currently formulated, has potential for abuse as people can file bogus and purposefully deceptive complaints or simply result in tip – offs. SEBI should exhibit the instruments available to them to forestall such abuse and ensure that the complaints are valid.
- ❖ Deploying extra resources and time to build up another division inside SEBI that explores the veracity of such complaints isn't simply strategically testing, yet additionally liable to make the primary insider trading investigations considerably more protracted.
- ❖ The Discussion Paper explicitly expresses that paltry and vexatious grievances would trigger regulatory action, yet this will require cautious thought and consideration.^{iv} Insider trading, as SEBI itself recognizes, is hard to demonstrate and definitive proof

may not be accessible, even to an informant. Along these lines, extensive proof should be given to prove the bona fides of the informant.

- ❖ Confidentiality of the complainant will be the essential proportion of the accomplishment of such an activity. The Discussion Paper expresses that the identity of the complainant stays anonymous except if their proof should be depended on in procedures. Such a special case may weaken the number of takers for this, particularly in situations where the informant is in a situation to give essential proof and henceforth is probably going to be required for the enforcement procedure also.
- ❖ Anonymous complaints can likewise be filed through lawyers who have the duty of keeping up the identity of the complainant. SEBI is, so far, quiet on the obligation guidelines that legitimate consultants will be held to if such privacy is undermined, in spite of their best measures and endeavors.
- ❖ In terms of the Discussion Paper, reporting to the internal compliance committee of a company is not considered for a reward. Given that the Insider Trading Regulations require listed companies to draft their whistle blower policy, SEBI may think about joining both. For instance, if a representative were to answer to the internal compliance committee of the company and within a recommended timespan, catch up with a SEBI grievance, at that point the individual ought to have the option to benefit of both protection and reward.

Bounty hunting in the corporate world encourages a fairly novel type of vigilantism; one that can benefit regulators and create more awareness but at the same time, fondle the regulators attention with deluding or unimportant issues. SEBI must consider stretching out its application to deceitful and unfair trade practices within companies as well. A large number of the ongoing concerns encompassing governance practices and market conduct issues in Indian companies are, in principle, similarly amiable to such a legal structure, given the similar set of constraints faced by SEBI during investigations.

INHERENT NEED FOR INFORMANT MECHANISM

The Committee on fair market conduct has made a few suggestions to fortify the legal structure for prevention of insider trading. Further, in Sahara India^v vide it's order dated 31-8-2012, the

Supreme Court expressed that Section 11(1) of the SEBI Act, 1992 throws a commitment to ensure the interests of the investors in securities by such measures as it might seem fit. In any case, the Nifty WhatsApp leak incident^{vi} which saw price sensitive information of a few Nifty companies being circulated through WhatsApp messages ahead of their scheduled disclosure to exchanges, ended up being the final nail in the coffin. The issue was considerably all the more upsetting in light of the fact that the vast majority of the sensitive information was in tune with those numbers to the tune of the last digit which were discharged subsequently. SEBI, then again was oblivious about the source of the leak, as it didn't have direct proof against the people associated with the alleged insider trading.

Henceforth, SEBI thinks that it's hard to build up its cases that insider trading occurred while possessing unpublished price sensitive information (UPSI). Setting up transmission of UPSI and proving flow of such information makes prosecution of defaulters hard for SEBI.

In the light of the previously mentioned proposals and cases, it is undeniable that there is an inalienable exigency of measures which control occurrences of insider trading. So in such manner, the proposed informant system will be advantageous as the employees of the company are probably going to be familiar with the deceitful exercises of the administration which are important to be established so that the abnormalities might be exposed and timely action can be taken.

REGULATORY FRAMEWORK FOR INFORMANT MECHANISM

On August 21, 2019, SEBI endorsed the SEBI (Prohibition of Insider Trading) (Third Amendment) Regulations, 2019 (Amendment).^{vii} The notable highlights are as per the following:

- ❖ A format has been recommended for informants to secretly submit 'original information', either legitimately or through their legal representatives, to a SEBI division that would be assigned as the Office of Informant Protection of SEBI. Such 'original information' is required to be solid, adequately specific and not known to SEBI from some other source.

- ❖ The amount of reward payable to the source has been capped at INR One Crore and the Investor Protection and Education Fund will be used for such payments. By and large, people who obtain such information through positions held in regulatory agencies, self-regulatory organizations or those who are under an obligation to report such information, for example, compliance officers would not be qualified for a reward, however SEBI has held the capacity to review such cases.
- ❖ Listed companies, intermediaries and fiduciaries are now required to incorporate a particular provision in their Internal Code of Conduct stipulating that no unfavorable move would be made against representatives who make a reporting to SEBI.

The advantages of introducing this mechanism, at least for the regulator gives him a stage to augment the net as far as insider trading convictions are concerned and increase the quality of proof and investigation procedures, the two of which right now experience the ill effects of various ailments like delayed investigations and failure in adducing the evidence or connecting the evidence to the accused. Having an informant's cooperation will build the regulator's success rates and help it in wrapping up a greater number of offenses than it can when applying a top-down methodology in particular. In this manner, rewarding informants additionally disincentivises unethical behaviour within organizations and makes employees increasingly wary about their very own conduct, since the regulator is constantly scrutinizing them.

MAJOR DRAWBACKS OF THE AMENDMENT

While gauging the potential of this Amendment, various issues arise for quick thought. While clear instances of exploitative trading behaviour will and ought to get picked up easily, there will without a doubt be increasingly unpredictable varieties of alleged insider-trading offenses that are drawn out into the open through this window. For example, a given circumstance will undoubtedly get increasingly unpredictable for both SEBI, as well as private entities, where there intermediaries included, and the employee of, either a broker dealer or an investment bank, decides to raise the details of a mind boggling transaction or trade, because of his/her very own individual impression of the insider trading dangers involved, will be outside the extent of the institutional view on the general legitimacy of the structure.

While such a hazard can in fact be said to have already existed, incentivizing and legitimizing it will without a doubt offer impetus to another set of difficulties to market players. Indeed, even where the entity emerges with a clean chit from the SEBI investigation, the quick effect on on-going transactions, client confidentiality, reputation as well as market perception and so forth., will unquestionably be a major concern, in spite of the circumspection which the SEBI vows to set out on such investigations.

Another component that merits some review is the way to deal with a co-operating offender or guilty party, who is happy to cite proof or is willing to adduce evidence as an informant in terms of this scheme. Under Regulation 7K, no absolution is proposed to be conceded to such parties, however they might be allowed to settle the issue in a confidential manner, i.e., with the goal that the identity of such individual isn't unveiled. This provision will undoubtedly bring forth another round of intense talk around the moral predicament that such activities present. While Regulation 7K doesn't give immunity, it grants SEBI to assess the degree of cooperation rendered at the time of the final determination of penalty, settlement or some other authorizations. The act of providing accused with a chance to change over their participation in an offense, into currency for a trade-off with the regulator doesn't go well with the regulator.

Be that as it may, in contrast to the US, given the administrative and quasi-judicial framework within which this is mulled over in India, SEBI should formulate explicit rules on the most proficient method to impartially deal with such cases, in a way that evokes veritable cooperation by abettors while simultaneously, not allowing them baseless leniency. Towing this scarce difference and guaranteeing that a cooperating informant doesn't treat the informant mechanism practically similar to a freebie, will be a tough assignment for the regulator, however one that will deliver rich profits in the event that they can devise a strategy that is predictable and objective.

Hence, administering this Amendment and setting up a deliberate governance structure will be significant for it to be successful, not simply in honing SEBI's scope as far as convictions and evidence collection is concerned, and in addition for keeping up the trust and authenticity of this route keeping in mind the simplicity of market participants.

CONCLUSION

In the US, the informant mechanism was viable and brought about the Commission getting 22000 informant tips since the origin of the program through the end of Fiscal Year 2017.^{viii} The mechanism proposed by SEBI is on similar lines. It proposes to require listed companies to additionally alter the Code of Conduct to guarantee protection of an employee filing VIDF. Powerful execution will rely upon sensitization of the mechanism to the employees as well as public. Individuals might be reluctant to approach except if there is a confirmation of satisfactory framework being set up for security of the informants. Finally, the provisions ought to indicate about likely action that might be made against informants if there should arise an occurrence of vexatious/negligible grievances. The system empowering informants to blow the whistle, be rewarded for the same and furthermore give them close to absolute confidentiality which will bring about an essential change to the guidelines. This is unquestionably a dynamic step ahead being taken by SEBI to forestall market abuse however the adequacy will altogether rely upon the productivity of the Office of Informant Protection.

REFERENCES

ⁱ Discussion Paper on amendment to the SEBI (Prohibition of Insider Trading) Regulations, 2015 to provision for an informant mechanism

ⁱⁱ blog.ipleaders.in/sebis-whistleblower-mechanisms-can-insider-trading-impeded/

ⁱⁱⁱ <https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf>

^{iv} <https://www.azbpartners.com/bank/recent-amendments-to-sebi-takeover-regulations-and-insider-trading-regulations/>

^v Sahara India Real Estate Corpn. Ltd. v. SEBI (2013) 1 SCC 1

^{vi} NSE, BSE Write to Companies over WhatsApp Earnings Leak, available at <<https://www.livemint.com/Money/kIFXwlUs6s8wjFhkYYkjzI/NSE-BSE-write-to-companies-over-WhatsApp-earnings-leak.html>>.

^{vii} https://www.sebi.gov.in/legal/regulations/sep-2019/securities-and-exchange-board-of-india-prohibition-of-insider-trading-third-amendment-regulations-2019_44341.html

^{viii} <https://www.sec.gov/rules/proposed/2018/34-83557.pdf>