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ROLE OF SEBI IN CURBING MARKET MANIPULATION AND INSIDER TRADING

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I. ABSTRACT

This research paper examines the role of SEBI in keeping the securities market free from fraudulent activities like market manipulation and insider trading. SEBI has enacted several legislation and guidelines to curb these malpractices in the market but instead of that, there are lots of cases of market manipulation and insider trading that occurred in the past few years.

Despite looking into numerous cases of insider trading over the past 20 years, SEBI has not been able to successfully convict many of them. The penalties are sometimes so minimal that any deterrent impact that the restrictions may have had is lost, even in cases where the offenders are apprehended and punished.

This research paper starts by analyzing the SEBI ICDR Regulations in facilitating capital issuances and how it is protecting investors' interests. Furthermore, it aims to descriptively analyze the SEBI Regulations regarding Insider Trading and Market Manipulation and how they help in curbing market manipulations. The researcher will also study the effectiveness of these regulations and whether these regulations are implemented or not.

This paper further discusses the present surveillance mechanism and investigation procedure of SEBI in case of market manipulation and insider trading and tries to find out the ways through which these surveillance mechanisms and investigation procedures can be made more effective.

Finally, this paper thoroughly analyzes the various challenges that SEBI faced while regulating the securities market, tries to identify potential areas for improvement, and

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suggests recommendations to enhance the effectiveness of SEBI in protecting the market from unfair practices.

II. KEYWORDS

SEBI, Fraudulent Activities, Market Manipulation, Insider Trading, Regulations, Surveillance mechanisms, Guidelines

III. INTRODUCTION

It is SEBI's duty to safeguard investors' interests and encourage the growth of the securities industry. The SEBI Act of 1992 grants SEBI legislative, executive, and quasi-judicial authority. In this way, SEBI protects the integrity of the markets by enacting laws that forbid insider trading and market manipulation in the securities market, and it punishes violators with disciplinary action.

In order to protect investors' interests and maintain fair market conduct and integrity, as well as protect against fraudulent operations, SEBI has created several laws and regulations. However, in order to guarantee adherence to the passed laws and rules, SEBI must establish efficient systems that support the identification of violations via efficient monitoring and inquiry.

SEBI had enacted "SEBI ICDR Regulations 2018", along with "SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003", and "SEBI (Prohibition of Insider Trading) Regulations, 2015", to protect the interests of investors against market manipulations, unfair practices, and Insider trading.

The main objective of this research project is to analyze the present surveillance mechanism and investigation procedure of SEBI in case of market manipulation and insider trading and aims to find out the ways through which these surveillance mechanisms and investigation procedures can be made more effective.

IV. SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2018

Section 11 of the SEBI Act empowers the board to make regulations for the safety and security of investors, regarding matters connecting to the issue of capital and disclosure requirements. In the exercise of powers conferred by section 11 of the SEBI Act, SEBI issued "SEBI (Disclosure and Investor Protection) Guidelines, 2000". Later on, "SEBI (Issue of Capital and Disclosure Requirements), 2009 replaced those guidelines".

After that, it underwent a number of revisions, but over time, market practices underwent substantial modifications. Because of this, SEBI established the ICDR committee in June 2017 to review the ICDR laws. Shri Prithvi Haldia serves as the committee's chairman. On the recommendation of this committee, new ICDR regulations were notified in September 2018, which replaced the old regulations.

These regulations primarily affect public offerings. According to regulation 24(1), "The draft offer document and offer document shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision". So, it is mandatory on the part of the issuer to disclose all relevant information necessary which is necessary for investors to make decisions regarding investment.

Regulation 24(3) says that "The lead manager shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft offer document and the offer document". And regulation 24(4) says that. "The lead manager shall call upon the issuer, its promoter, and its directors, to fulfill their obligations as disclosed by them in the draft offer document and the offer document and as required in terms of these regulations". So, it is the responsibility of the manager to exercise due diligence and also has the supervisory power to see whether promoters or their directors have fulfilled their obligations or not regarding disclosure. Also, according to regulation 24(5), "The lead manager shall ensure that the information contained in the draft offer document and offer document and the particulars as per restated audited financial statements in the offer document are not more than six months old from the issue opening date". So, it is the responsibility of the lead manager to update all the information contained in the offer document.

This regulation mandates that the Issuer post the audited financial statements for the previous three fiscal years on its website and give a link to the website in the offer document for those financial statements. Additionally, an issuer must post a link to the financial statements of its material subsidiaries for the last three fiscal years on its website or submit the financial statements itself. If a subsidiary adds 10% or more to the issuer's turnover, net worth, or earnings before taxes in the consolidated annual financial statements of that year, it is deemed substantial.[3]

V. SEBI (PROHIBITION OF FRAUDULENT AND UNFAIR TRADE PRACTICES RELATING TO SECURITIES MARKET) REGULATIONS, 2003

By exercising powers conferred by section 30 of the SEBI Act, SEBI has enacted SEBI (PFUTP) Regulations, 2003. The main objective of this act is to prevent market manipulations which is due to unfair practices prevalent in the securities market. This can be done by detecting and punishing such unfair or fraudulent activities.

Section 11 (2) (c) of the SEBI Act prohibits every activity in the securities market that may come under fraudulent and unfair trade practices. However, it does not specify as to which practices are to be considered fraudulent and unfair trade practices. However, this SEBI (FUTP) Regulation has defined the term fraudulent and unfair trade practices. According to Regulation 2(b), "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 to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss". So, we can see that the term 'fraud' has been

[3] Gokul Rajan and Shatarupa Dasgupta, *India: Financial Disclosures Under The New ICDR Regulations – Half A Step Forward*, MONDAQ (May 15, 2019), https://www.mondaq.com/india/securities/805732/financial-disclosures-under-the-new-icdr-regulations-half-a-step-forward.

given a wider and more inclusive definition in this regulation than in Section 17 of the Indian Contract Act.

The Supreme Court defined 'unfair trading practices' as "a practice that does not conform to the fair and transparent principles of stock market trades."[4]

The court's definition of market manipulation is found in "*SEBI v Rakhi trading*" as follows: "Market manipulation is a deliberate attempt to interfere with the free and fair operation of the market and create artificial, false or misleading appearances concerning the price, market, product, security and currency".[5]

To gain the trust and confidence of the investor, the securities market must be free from malpractices and fraudulent activities. In India, SEBI has the power as well as the responsibility to ensure that the market remains fair and free from any malpractices. This regulation made by SEBI is one of those regulations which aims to curb market manipulation and unfair practices. Regulation 4 of this SEBI (PFUTP) Regulations, 2003 prohibits manipulative, fraudulent, and unfair trade practices.

According to this regulation, “no person shall indulge in a manipulative, fraudulent or an unfair trade practice in securities market”. The heading of regulation 4 includes the term manipulative, but the regulation does not mention the term ‘manipulative’. The 2017 Committee on Fair Market Conduct made the following recommendation: "It would be prudent to include the words manipulative in regulation 4(1) to ensure consistency between the heading and principle.”[6]

The SC in *N Narayanan v Adjudicating Officer* held that “The SEBI Act and PFUTP standards were not met by practices that failed to reveal enough information about the company, which was essential for proper pricing of the companies' securities and for the smooth operation of the market.”[7] Therefore, the SC has enhanced the scope and ambit of these regulations.

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[4] SEBI v Rakhi Trading Pvt Ltd, 2018 SCC Online SC 101.
[5] *Id*.
[6] K SEKHAR, GUIDE TO SEBI CAPITAL ISSUES, DEBENTURES & LISTING 5384 (LexisNexis 2019).
[7] N Narayanan v Adjudicating Officer, SEBI 2013 12 SCC 152.

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VI. SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

Taking the authority granted by sections 11 and 30 of the SEBI Act, SEBI has promulgated the SEBI (Prohibition of Insider Trading) Regulations, 2015 in implementation. This regulation's primary goal is to reduce insider trading in the securities industry.

“Sachar committee” was appointed by the central government in 1978. This committee recommended several reforms in the Company Act, of 1956. The committee recommended full disclosure to the Board of Directors regarding the purchase or sale of securities by any person who is connected to the company.

“Insider trading generally means trading in the shares of a company by the persons who are in the management of the company or are closely related to them, based on undisclosed price sensitive information regarding the working of the company which they posses but are not available to others”.[8]

Regulation “2(g) of SEBI (PIT) Regulations, 2015” defines the term ‘insider’ as, “any person who is a connected person, or in possession of or having access to unpublished price sensitive information”. Therefore, anyone who meets the criteria for a connected person in Regulation 2(d) and who possesses unpublished price-sensitive information as specified in Regulation 2(n) is regarded as an insider. The onus of establishing a certain person as a connected person is on the Board, but once it is established then the onus shifts on that connected person.

Regulation 2(d) defines a 'connected person' as "any person who is or has been associated with a company, directly or indirectly, in any capacity, including because of frequent communication with its officers, or by being in any contractual, fiduciary, or employment relationship, or by being a director, officer, or employee of the company, or holds any position, including a professional or business relationship." The ambit of this definition is very wide, which also includes the person who may not

[8] K SEKHAR, GUIDE TO SEBI CAPITAL ISSUES, DEBENTURES & LISTING 5384 (LexisNexis 2019).

hold a position within a corporation but maintains consistent communication with the organization.

Furthermore, regulation 2(n) defined 'unpublished price sensitive information' as, "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". Therefore, any information about the business or its securities that could have an impact on the price of shares is considered unpublished price-sensitive information.

Regulation 3 puts restrictions on the communication or procurement of "unpublished price-sensitive information". According to regulation 3(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 such communication is in furtherance of legitimate purposes, the performance of duties or discharge of legal obligations".

And regulation 3(2) says that, "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, the performance of duties or discharge of legal obligations". So, an insider must handle such information with due care. This regulation puts restrictions on the communication or procurement of information by insiders or any other person.

Regulation 4 puts restrictions on trading by the person who has unpublished price-sensitive information. According to regulation 4, "No insider shall trade in securities that are listed or proposed to be listed on a stock exchange when in possession of unpublished price sensitive information". This is a very important provision because if an insider is allowed to do trade, then it is unfair to the person who does not have any "unpublished price-sensitive information".

Regulation 6 puts the obligation of disclosure of trading by insiders as well as his immediate relatives or other persons who take his advice while trading. According to regulation 6(2), "The disclosures to be made by any person under this chapter shall include those relating to trading by such person's immediate relatives, and by any other person for whom such person takes trading decisions". This provision intends to prevent abuse by trading when done by an insider or any close associate of that person because it gives them undue advantage over another person who does not have any "unpublished price sensitive information".

Regulation 10 provides that, "Any contravention of these regulations shall be dealt with by the Board as per the act". So, this regulation does not contain any provision which prescribes penalties for insider trading. The penalty is prescribed under section 15G of the SEBI act, which provides, "penalty for insider trading shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher".

While section 24 of SEBI act says that, "any person who contravenes the provision of the SEBI Act or any rules or regulations made thereunder, shall be punishable with imprisonment for a term which may extend to one year, or with fine, or with both". So, the offense of Insider trading is punishable by one-year imprisonment or with a fine or both.

VII. ROLE PLAYED BY SEBI

The emergence of the securities market as the major market for meeting the long-term requirement of funds is one of the major economic developments of the 1980s. This brought crucial changes and introduced new intermediaries and institutions in the securities market. Several companies entered the capital market at that time. All of these developments brought significant risk for investors and there was a need for adequate legislation which protects the interest of investors.

The Indian government approved a resolution on April 12, 1988, establishing the SEBI, whose main goals are to regulate the securities market and protect investor interests.

The preamble of the SEBI Act says that "SEBI is enacted to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto". Therefore, the primary goal of SEBI is to safeguard the interests of investors by ensuring that the securities market is free of any fraudulent or unjust practices. For

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this purpose, SEBI has enacted multiple legislation like SEBI (PFUTP) Regulations, 2003, SEBI (PIT) Regulations, 2015, SEBI (ICDR) Regulations, 2018.

SEBI has wide power regarding market manipulation and insider trading. If there is reasonable ground to believe that any activities or transactions in the securities market are not fair and against any provisions of the SEBI Act or any other existing regulations, then SEBI has the power to investigate the matter.

The Supreme Court in "*N. Narayanan v. Adjudicating Officer, SEBI*"[9], pointed out that the share market must remain transparent and SEBI must firmly address the directors and businesses engaged in insider trading and market manipulation.

In the "*Indian Council of Investors v. Union of India*"[10], the Bombay HC observed that SEBI has extensive powers under the SEBI Act, including the ability to demand call logs from telecommunications carriers. It further held that the authority to summon phone records can only be used when there is an ongoing investigation or inquiry.

Section 15 G of the SEBI Act, empowered the SEBI to impose penalties for insider trading. The Bombay High Court in "*SEBI v. Cabot International Capital Corporation*" held that "Under the SEBI Act and SEBI Regulations, men's rea is not a necessary component of punishment because the element of a crime is not present as needed by the criminal law."[11]

Thus, it is evident that SEBI has the authority to prohibit insider trading and manipulate the market. It also has to safeguard investor interests and ensure that there are no fraudulent actions occurring in the securities market.

SEBI has examined various insider trading allegations over the previous two decades but has had a low percentage of successful convictions. Even when the culprits are apprehended and punished, the penalties are sometimes so lenient that the regulations lose any deterrent effect they may have.

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[9] N. Narayanan v. Adjudicating Officer, SEBI, 2013(3) R.C.R (Civil) 68 (India).
[10] Indian Council of Investors v. Union of India, (2014) 186 Comp Cas 512 (India).
[11] SEBI v. Cabot International Capital Corporation, (2004) 51 SCL 307 (Bom) (India).

During the fiscal year 2018-19, SEBI investigated 84 new cases of market manipulation and price rigging, with 60 cases completed, and 70 cases of insider trading, with 19 concluded.[12]

During 2020-21, 161 new cases involving market manipulation and insider trading were filed, with 170 instances completed.[13]

VIII. SUPERVISION AND SURVEILLANCE BY SEBI

The primary responsibility of market surveillance and supervision is vested in Stock exchanges. However, SEBI keeps monitoring the market movement and plays a vital role in ensuring that the market remains free from insider trading and market manipulation.

To monitor abnormal market activities and to prevent market manipulation, a "market surveillance division" was set up in SEBI in July 1995. Market surveillance and supervision play a very crucial role in protecting market integrity and safety.

SEBI surveillance mechanism primarily focuses on policy formulation for safety and stability in the Indian securities market. It closely monitors the market movement to find out any unfair practices of market manipulation. It also prepares reports and studies on market movements, which ultimately helps in enhancing the surveillance mechanism. Despite that, SEBI has not achieved its objective completely and failed to curb the practice of market manipulation and insider trading.

The lack of serious punishment for market manipulation and insider trading is the major reason for the ineffectiveness of SEBI regulations. Also, the mechanism for investigation is not adequate. SEBI has only 800 (approx.) employees not constituting enough human resources to conduct a proper investigation.[14]

IX. CONCLUSION & SUGGESTIONS

SEBI regulates India's securities market. SEBI is responsible for protecting investors' interests in the securities market, as well as promoting and regulating its growth. The

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[12] Annual report of SEBI for Financial Year 2018-19.

[13] *Id*.

[14] Guest, *Why SEBI is Failing at Regulating Insider Trading in India*, IndiaCorpLaw (Sep. 12, 2023, 9:55 PM), https://indiacorplaw.in/2018/02/sebi-failing-regulating-insider-trading-india.html.

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securities market is based on the trust and confidence of investors. This trust and confidence increase if the market remains free from any malpractices and insider trading. The presence of SEBI as a regulator also increases the trust and confidence of investors.

SEBI Act itself provides that the basic objective of the board is to protect the interest of investors by making the market free from any unfair practices or insider trading. SEBI has enacted a number of laws and regulations to safeguard market integrity, fair market conduct, and protection against fraudulent operations in the best interests of investors. Some of these regulations are the SEBI (ICDR) Regulations, 2018, SEBI (PFUTP) Regulation, 2003, and SEBI (PIT) Regulations, 2015, to protect the interest of investors by preventing market manipulation and insider trading. Due to the presence of these regulations, unfair or fraudulent practices in the securities market remain under control.

However, these regulations can be made more effective by adopting robust surveillance mechanisms and thorough investigation procedures. Currently investigating the procedure of SEBI is not so effective and it takes lots of time. Surveillance mechanisms can be made more effective by adopting the latest technologies.

Generally, the offender of market manipulation or insider trading is a very rich and powerful person. The punishment or penalties provided under these regulations are not sufficient to create any deterring effect. So, there is a need to enhance the quantum of punishment and penalties for market manipulation and insider trading under these regulations. This research paper has analyzed the present surveillance mechanism and investigation procedure of SEBI in case of market manipulation and insider trading and also found out the ways through which these surveillance mechanisms and investigation procedures can be made more effective.

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