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Expert Expressions
Corporate Governance Demystified

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A series of interfaces with the entire range of stakeholders of Corporate Governance, has given rise to a number of questions, issues, concerns and, happily, some suggestions and solutions. In each issue of this monthly newsletter, we will be getting two experts to articulate their thoughts on a specific topic. The ninth issue is now with you. Needless to add, we welcome your feedback.

Editor

INSIDER TRADING – THE HOMEGROUND DISADVANTAGE?

The scourge of insider trading, taking advantage of information asymmetry, has been the bane of the Indian securities market. Responding with a seemingly heavy hand, the market regulator has put in place a stringent framework that is said to border on regulatory overreach. Violating the "need to know" principle even in the absence of a consequent trade, is an offence. Wasn't the regulation meant to address insider trading? Is the insider at a disproportionate disadvantage? Suresh Talwar and Suresh Senapaty address our information asymmetry.

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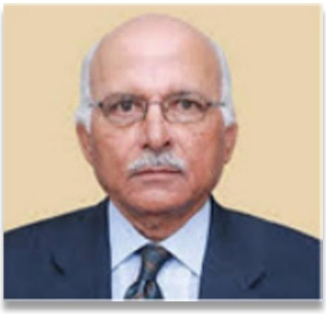

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Insider trading is the act of trading, directly or indirectly, in the securities of a publicly listed company by any person, based on certain information, not available to the public at large, that can influence the market price of the securities of such company.

The PIT 2015 casts a restriction on the "insider" from communicating, providing, or allowing access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, to any person including other insiders except where such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. Clearly, this is a deviation from the PIT 1992 where trading by the person in possession of unpublished price-sensitive information amounted to the contravention of regulations.

The present provision is intended to cast an obligation

Progress in human civilization is measured by what people treasure and protect. It was human life at first, which was soon followed by property. In its evolved state, information is prized almost as much as human life and property. Securities market is a good example where access to authentic information is what separates a possible profit from a possible loss.

Corporate insiders are in a unique position to profit as they have constant access to price-sensitive information which is not available to outsiders. Given this situation of inequality, insider trading regulations grew out of the need to attract outside investors to invest in the company. The stronger the insider trading regulations, the higher is the valuation as more investors are attracted. The U. S. market is a good example.

In this crusade to protect value for outsiders, it does happen that the freedom of the insiders to trade in on all insiders who are essentially persons in possession of unpublished price sensitive information to handle such information with care and to deal with the information with them, when transacting their business strictly on a need-to-know basis.

This near-absolute restriction on sharing of information with others – whether there is any trading in a company's shares or otherwise, creates many impediments in the operations of group companies. The question that begs consideration is whether in professionally managed companies, the largest shareholder needs to know anything about the company in which she/it holds shares. Does a brand owner 'need to know' anything about the company which is using its brand? What percentage of shares of the company does the largest shareholder need to hold, before she/it qualifies to receive price-sensitive information from a company? The unravelling of the Tata-Mistry standoff will raise several of these questions and hopefully provide some answers to avid students of the law.

their own stock is restricted. The principle of 'abstain or disclose' and the practice of trading bans prior to quarterly result declaration, owing to the presumption of insiders having price-sensitive information, are two well accepted restrictions. Even these seemingly rigid restrictions on insiders can be addressed with publicised trading plans which permit the insider to execute trades during these restricted periods.

Given the way regulations on insider trading have evolved, it is difficult to say that insiders have a homeground disadvantage, especially as insider trading curbs and restrictions are primarily meant to enhance the value of the company that the insiders have a long-term stake in.