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CHAPTER. 1:

I. INTRODUCTION:

The securities market is a segment of the financial market in which securities transactions have occurred. Similar to other financial markets, the securities market is susceptible to fraud, illegal activity, and cons. The Indian securities market is comprised of millions of active investors who invest and profit daily through trading. To protect the interests of all investors in the securities market, it is of utmost importance to prevent and control market scams and frauds. Due to the expansion of the securities market in the Indian economy in 1992, the government of India established the *Securities and Exchange Board of India (SEBI)* as a regulatory agency to oversee the market. ***The Securities and Exchange Board of India (SEBI) has been tasked with the following responsibilities:***

- 1. safeguarding the interests of investors in the securities market.*
- 2. regulating the functioning of the securities market*
- 3. advancing and promoting the securities market*
- 4. regulating the company's internal transactions*

II. INDIA'S DEVELOPMENT OF UNFAIR TRADE PRACTICES:

Several fraudulent practises are prohibited by the *SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations 2003 (hereinafter "SEBI Regulations")*. Front running is one of the prohibited fraudulent practises. In the past year, front running has been at the centre of debate regarding the severity of the offence. It has been defined as "A broker's or analyst's use of non-public information to acquire securities or enter into options or future contracts for his or her own benefit, knowing that the price of the securities will change predictably when the information becomes public."¹ Front running has been defined in a SEBI Circular as² "means usage of non-public information to directly or indirectly, buy or sell securities or enter into options or futures contracts, in advance of a

¹ *Eight Edition of Black's Law Dictionary*, referred to in Front-running – Applicable to non-Intermediary.

² *SEBI Circular on Consent Orders as amended by Circular CIR/EFD/1/2012 Insider Trading and Front Running Laws In India and Role of Compliance Officers.*

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substantial order, on an impending transaction, in the same or related securities or futures or options contracts, in anticipation that when the information becomes public; the price of such securities or contracts may change”. The securities market is a section of the financial market, where securities transactions have been conducted. Similar to other financial markets, the securities market is susceptible to fraud, illegal activity, and cons. The Indian securities market is comprised of millions of active investors who invest and profit daily through trading. To protect the interests of all investors in the securities market, it is of utmost importance to prevent and control market scams and frauds.

III. UNFAIR, MANIPULATIVE, AND DECEPTIVE COMMERCE

PRACTICES:

According to the Securities and Exchange Board of India’s Prohibition of Fraudulent and Unfair Trade Practices in accordance to the Securities Market Regulations, 2003, “*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 in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss*”.

IV. PROHIBITION OF FRAUDULENT, MANIPULATIVE AND

UNFAIR TRADE PRACTICES:

The Securities and Exchange Board of India (SEBI) is responsible for prohibiting manipulative, fraudulent, and unfair securities market practices. Chapter II (4) of the 2003 regulation contains a unique regulation prohibiting manipulative, fraudulent, and unfair trade practices. This regulation was created by SEBI in response to numerous unfair practices and frauds affecting the securities market.

The following rules are as follows:

- *No one shall directly or indirectly participate in fraud related to the sale, purchase or negotiation of securities;*

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- *No one shall use any manipulation or deception to violate the provisions of the law ;*
- *No one shall adopt any plan, Equipment or strategies to deceive securities-related transactions.*
- *Dealing with securities for the purpose of exaggerating or causing value fluctuations is not allowed, but it must only be used for the transfer of ownership.*
- *No one shall pay any person money or the equivalent of money for the purpose of processing securities for the purpose of causing volatility or inflation.*
- *Manipulation of securities prices is not allowed.*
- *No false information is allowed to allow individuals to process securities.*
- *Do not deal with securities without intention to comply with or change ownership.*
- *No one should deal with stolen or forged securities.*

CHAPTER 2:

V. PROVISION OF FRONT RUNNING UNDER SEBI

REGULATIONS:

Under Section 4(2)(q) of the SEBI Regulations, front running has been specifically designated as an offence. It reads as follows:

"Dealing in securities shall be considered a fraudulent or unfair trade practise if it involves fraud and may include:

(q) an intermediary buying or selling securities in advance of a substantial client order or whereby a futures or option position is taken in anticipation of an impending transaction in the same or related futures contract."

Regulation 3 of the SEBI Regulations is a more general provision that addresses a variety of fraudulent activities³, including front running. In the securities market, front running is the unethical practise in which a broker trades equity based on information received from the analyst department before informing his or her clients.⁴ *The Securities Exchange Board of India*

³ Defined under Regulation 2(c) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003.

⁴ *Front Running: The definition Conundrum*, HARDEEP SINGH CHAWLA.

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(Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995 (hereinafter '1995 Regulations') attempted to regulate front running for the first time in India. However, the term "front running" was not used in these regulations. Article 6(b) of the 1995.

VI. DIFFERENT KINDS OF UNFAIR TRADE PRACTICES:

VI.I FALSE REPRESENTATION:

The act of making any statement or representation, whether orally or in writing, that:

- *falsely implies that the goods are of a specific quality, amount, grade, composition, style, or model.*
- *any re-built, second-hand restored, reconditioned, or old products are falsely represented as new goods;*
- *indicates sponsorship, approval, performance, qualities, accessories, uses, or benefits not found in the items or services*
- *gives any promise or assurance about the goods' performance, efficacy, or life span that isn't based on a sufficient or proper test;*
- *intentionally misleads the public regarding the prices at which such goods or services are accessible.*

VI.II FALSE 'BARGAIN PRICE' OFFER:

Unfair trade practices occur when an advertisement is published in a newspaper or elsewhere in which products or services are offered at a bargain price when there is no intention of the same being given at that price for a reasonable period of time or in a reasonable quantity. for this context, the term “*bargain price*” refers to:

- *the price is indicated in the advertisement in such a way that it appears to be lower than the usual price, or*
- *the price that everyone who sees the advertisement would believe is lower than the price at which such things are normally sold.*

VI.III BID RIGGING:

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It is against the law for two or more competing parties to collude to determine the winner of a bidding procedure. When bidders collude, the bidding process is harmed, and the resulting price may be higher than what would have been obtained through a free market, competitive bidding process. Bid rigging is possible in any industry where commercial contracts are awarded through a competitive bidding process, such as automobile and real estate auctions, construction projects, and government procurement contracts.

VI.IV CARTELS:

A cartel is a formal agreement between a group of producers of a product or service to manage supply and influence prices. In other words, a cartel is a group of normally independent businesses or nations that act as if they were a single manufacturer, allowing them to set prices for goods and services without competition. Cartels consist of competitors in the same industry who agree on a pricing control strategy to reduce competition. Cartels employ strategies such as supply restriction, price fixing, collusive bidding, and market segmentation. In the majority of locations, cartels are considered illegal and anti-competitive behaviour promoters. Due to increased prices and a lack of transparency, cartel activities are detrimental to consumers.

Regulations stated that *"no person shall knowingly purchase, sell, or otherwise deal with securities pending execution of any order of his client relating to the same security for purchase, sale, or other transactions in respect of securities"*. However, because the provision stated *"pending execution of any order of his client,"* it was clear that the provision only applied to front running by brokers, despite the fact that the beginning of the paragraph stated *"no person shall,"* indicating that front running was prohibited by all parties.

Regulation 18 of the Securities Exchange Board of India (Mutual Funds) Regulations, 1996 (*hereinafter "Mutual Funds Regulations"*) contains the first direct mention of front running (23). The regulation required trustees to submit a certificate every six months to the *Securities Exchange Board of India (SEBI)* stating that they were satisfied that there had been no instances of front running by trustees, directors, or key personnel of the asset management company. Thus, it can be inferred from these Mutual Fund Regulations that SEBI's

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understanding of front running was not limited to the activities of only brokers, although there was no front running case under the 1995 Regulations that SEBI dealt with. *The Securities Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 2003 (henceforth "2003 Regulations")* revoked and replaced the 1995 Regulations. Even the 2003 Regulations do not use the term 'front' directly.

VII. FRONT RUNNING: THE DEFINITION CONUNDRUM:

It is crucial to look at the definitions of both front running and intermediary because it is around these two words that the contentious legal issues revolve in order to fully and completely understand the concept of front running and the context of the same holistically as well as the effects of the SAT decision on the securities world. Originally, "*front running*" was defined as buying or selling assets before a significant transaction in order to profit from the ensuing price change. This refers to people who are trading in the market while aware that a significant transaction will occur soon and that the odds are in their favour.⁵ The term "*intermediary*" refers to stockbrokers, share transfer agents, sub-brokers, trustees of trust deeds, bankers to issues, merchant bankers, portfolio managers, registrars of issues, investment advisers, participants, credit rating agencies, custodians of securities, and any other intermediaries that SEBI specifies. It also includes asset management firms as defined by the Mutual Fund Regulations, trading members of a derivative segment, and currency derivative segment members.

In the recent case of *Dipak Patel vs. Securities and Exchange Board of India*⁶, the SAT had to decide what constituted front running specifically and if anyone other than an intermediary may be held accountable under Regulation 3 of the 2003 Regulations. The SAT ruled that, absent any other particular provisions, a person other than an intermediary cannot be considered to have engaged in front running operations and penalised as such.

⁵ P RAMANATHA AIYAR, LAW LEXICON (4TH EDITION 2010).

⁶ Dipak Patel v. SEBI Appeal No. 216 of 2011; Date of Decision – November 9, 2012. Appeal nos. 74 and 78 of 2012 also combined.

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CHAPTER. 3:

VIII. THE SECURITIES MARKET:

One of the top ten markets in the world is the Indian securities market, which is regarded as one of the most promising rising markets. It is important to remember that the value of stocks, bonds, and other securities cannot be guaranteed by the government of the country and is subject to manipulation by other investors and market participants. Regulations are extremely important in the securities markets since the lack of perfect competitive conditions and the information asymmetry present make it possible for some participants to unfairly exploit investors by taking advantage of regulatory inadequacies.⁷ Price-fixing and other fraudulent actions not only result in significant financial losses for investors but also disrupt the proper operation of the securities markets and the effective distribution of the economy's investable resources. The following section discusses insider trading, price manipulation, and frauds involving dissolving corporations as the key areas of worry for the investor community in the securities market.

The SEBI can conduct investigations into instances of market manipulation and fraudulent and unfair trade practises according to the ***2003 SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations and the 1992 Insider Trading Regulation***. A violation of the regulations occurs when someone engages in behaviour that gives the impression that there is trading going on in the securities market. The regulations expressly forbid unfair commercial practises in relation to securities as well as fraudulent dealings, market manipulation, and deceptive claims to induce the sale or purchase of securities. SEBI has the authority to investigate any individual who is buying, selling, or otherwise transacting in securities, either on its own initiative or in response to information that it has received from an investigative officer. SEBI may take steps to suspend or revoke an intermediary's registration based on the report of the investigating officer.

⁷ Suchismita, “Securities Market Regulations: Lessons From Us And Indian Experience”, Money And Finance, January –June, 2005.

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IX. THE RECENT DISCUSSIONS:

Front running in the SAT was first brought up in *Dipak Patel vs. SEBI*,⁸ in 2012. It was argued that Dipak Patel's case did not fall under the front-running rule since Regulation 4(2)(q), which forbade the practise, was only applicable to intermediaries, and that as a result, Dipak Patel was not subject to any penalties.⁹ The Tribunal gave the provision a literal interpretation and agreed with Dipak Patel's argument that the relevant provisions only apply to "*intermediaries*" and do not apply to anyone else. The Tribunal stated that there is no specific provision in the Act, rules, or regulations that forbids front running by anyone other than an intermediary. *Surjit Karkera vs. SEBI*¹⁰, The Tribunal's decision was upheld because it was congruent with the argument that the application of the provision is limited to "intermediaries" only because Regulation 4 (2)(q) expressly indicates as much.¹¹

X. THE AMERICAN VIEWPOINT:

Recently, the US decided to broaden its front-running policy, and as a result, the Financial Industry Regulatory Authority authorized a proposal (FINRA). Prior to the deal becoming known to the public, they continued to operate on their previous front-running policy. While keeping the "*publicly available information*" provision in place, the FINRA plan created a new standard for when the material became "*stale or outmoded.*" Therefore, the limitations on frontrunning will no longer be in effect if one of these two criteria is satisfied, i.e., if the knowledge becomes "*publicly available*" or "*stale or outmoded.*" Both of these requirements are based on the specific facts and circumstances of each case, including things like the amount of time that has passed since the transaction, a significant shift in the market, the members' awareness of the transaction, etc. The definition's proposed expansion is intended to cover "all securities, financial instruments, and contracts (*in addition to the current options and security futures*) that overlay the security that is the subject of an impending block transaction and that

⁸[2013] 112 CLA 97 (SAT).

⁹ *SAT now holds front running to be an offence*, JAYANT THAKUR.

¹⁰ *Surjit Karkera v. SEBI Appeal No.167 of 2012*.

¹¹ Another SAT Order on Front Running, Umakanth Varotill, available at <http://indiacorplaw.blogspot.in/2012/12/another-sat-order-on-front-running.html>.

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have a value that is materially related to, or otherwise acts as a substitute for, the underlying security." It takes a definition this wide and inclusive to avoid fraud while also ensuring open and free markets available to everyone. The United States SEC, in contrast to the Indian SAT, does not categories the types of individuals to whom these front-running limitations apply.

CHAPTER. 4:

XI. HOW MAY UNFAIR TRADE BE REPORTED?

The Investor Services Cell of the Exchange handles investor complaints against Trading Members of the Exchange or listed companies. Investors may electronically submit their complaints using the website www.nseindia.com or by mailing their complaints to the closest investor service centre in the format provided by the Exchange, along with any necessary supporting documentation.

XII. SECRET TRADING:

An insider is a connected person or someone who has access to or possesses such proprietary, price-sensitive information. Insider trading is the activity of trading in a company's securities by individuals who, as a result of their employment, have access to information that is otherwise private and may be crucial in determining an investment strategy. In other words, insider trading is the act of purchasing or selling securities of a firm while possessing material nonpublic information about the company's operations or other worries. It can be summed up by saying that it refers to trading in a firm's securities based on specific private information about the company that is either not disclosed or already known to the public, i.e., unpublished price-sensitive information.

Insider trading consists of three basic elements:

- 1. There must be significant non-public information.*
- 2. Only a select group of people have access to this knowledge, which must originate from an inside source.*
- 3. These people are required to trade securities using substantial information that is not generally known.*

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XIII. THE CONSEQUENCES OF INSIDER TRADING:

The SEBI (Prohibition of Insider Trading) Regulations, 2015 were approved by the Securities and Exchange Board of India (SEBI) on January 15, 2015. This regulation's major goal is to emphasize that ownership of such information should only belong to the person making the decision, not the person who also owns the business.

XIV. THE FOLLOWING ARE THE PENALTIES FOR INSIDER TRADING:

According to sections 15G and 24 of the SEBI Act, insiders who violate the 2015 regulations are subject to fines of up to 25 crores or three times the profit made from insider trading, whichever is higher, as well as up to ten years in prison or fines of up to 25 crores, or both.

- *Section 11(c)(6) of the SEBI Act stipulates that anyone who willfully refuses to help in a SEBI inquiry into insider trading is subject to a maximum one-year prison sentence, a maximum fine of Rs. 1 crore, or both, as well as a daily fine of up to Rs. 5 lakhs.*
- *Section 11(4)(b) of the SEBI Act gives SEBI the authority to direct such insiders not to trade in the relevant securities in a particular way, to forbid him from selling the relevant securities, to deem the relevant transaction(s) of securities null and void, and to prohibit the relevant insider from advising others to trade in securities.*
- *If an insider violates section 195 of the Companies Act, 2013, they could receive a five-year prison sentence, a fine of up to 25 crore rupees, three times their insider trading profits, or both, depending on the severity of their offence.*

CHAPTER. 5:

XV. CONCLUSION:

Provisions addressing fraudulent acts like front-running require interpretation since they are high-stakes offences with far-reaching implications. As a result, not only do these actions shake the faith of current investors, but also of potential new investors, who may be put off from entering the securities market altogether. A spirit of fair play must be preserved in the market,

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as stated in Surjit Karkera, "so that innocent investors do not find themselves on the receiving end of improper behaviour by businesses in the market." In order for a market to flourish and grow steadily over time, it must be protected from fraud, illegal activity, injustice, and manipulation. The stock market is no exception to this rule. To guarantee sustainable development and safeguard investors, the *Securities and Exchange Board of India (SEBI)* has implemented stringent regulations. India's population and the influx of new investors create an environment where fraudsters may easily take advantage of a sizable portion of the market's participants. Meanwhile, the country's cybersecurity infrastructure lags behind that of more developed nations. *Securities and Exchange Board of India (SEBI)* should create cybersecurity rules and a cybersecurity wing to secure the securities market from any potential cyber-attack, as most securities transactions are now conducted online through various platforms, applications, and other ways.

XVI. SUGGESTIONS:

Regulator Sebi has sought authority to audit the books of accounts of listed businesses for violations of any securities law and to take direct action against the fraudsters in an effort to prevent financial fraud. Furthermore, Sebi has recommended a severe penalty for intentionally interfering with, hindering, or influencing a legal investigation by destroying, mutilating, manipulating, or forging records, documents, or other tangible materials. Sebi ought to be given a greater amount of authority. Currently, Sebi has the authority to undertake such audits in the event of insider trading or fraudulent or unfair business activities. However, according to a senior official, the regulator has recently requested that the government expand its authority to check the accounts of listed businesses to include violations of all securities laws, rather than just those related to a select few regulations. Under the SEBI Act, if the regulator has reasonable grounds to suspect that a listed company has engaged in insider trading or fraudulent and unfair trade practises relating to securities markets, it may conduct an inspection of any book, register, or other documents and records maintained by the company. The Securities and Exchange Board of India (Sebi) has recently proposed expanding this authority to cover all situations where the regulator has reasonable grounds to suspect a violation of any securities law. It has

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been urged by Sebi that any disgorgement order for recovery of illicit gains should be equally applicable to all joint actors, regardless of the earnings or avoided losses of the violators. Another proposed change to the Sebi Act would see the word "*material or non-public knowledge*" replaced with "*unpublished price sensitive information*" for more consistency in legal terminology used for insider trading prohibitions. These permissions ought to be given. The regulator has also proposed modifying the present insider trading penalty from dealing in securities "*on the basis*" of substantial or non-public knowledge to "*while in possession*" of such information. Sebi believes that all acts of altering, destroying, mutilating, concealing, or falsifying the data in order to hinder investigation should be classified as "*fraudulent*" and actionable under the securities laws, and thus a higher penalty should be imposed for doing so. The penalty for such behaviour would begin at Rs 5 lakh and may go as high as Rs 10 crore or three times the profit made from such behaviour, whichever is greater. No person shall use or assist in the use of any device, scheme, or artifice to manipulate the books of accounts or financial statements of a listed company to directly or indirectly manipulate the share price, or to conceal the diversion, syphon off, or steal the funds, assets, or earnings of a listed firm or a proposed-to-be-listed company, as stated in another proposed amendment by Sebi. The Securities and Exchange Board of India (Sebi) believes it should have the authority to pursue legal punishment against those responsible for financial fraud, since such crimes hurt not only the company's owners but also investors' faith in the securities markets. Under the Firms Act, the Ministry of Corporate Affairs is primarily responsible for overseeing or supervising the books of accounts of companies. However, Sebi has proposed that it be granted the authority to take immediate action in the event of fraud committed by manipulating the books of accounts or the financial statements of listed businesses. Share price manipulation, concealing money diversions, misusing public issue proceeds, and syphoning off revenues, assets, and earnings are all common goals of such activities. The regulator has proposed the change after receiving advice from the Fair Market Conduct Committee it established. These recommendations from Sebi should be submitted to the regulatory body as soon as possible to help stop misconduct and fraud.