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Impact of Insider Trading on Investment Decision by Investors

Dr. Deepa Pillai[1]
Assistant Professor
Department of Finance
Indira Institute of Management
Pune, Maharashtra – India

Shayan Kar[2]
MBA- Student
Indira Institute of Management
Pune, Maharashtra – India

Rutvika Shah[3]
MBA- Student
Indira Institute of Management
Pune, Maharashtra – India

Abstract: Insider trading is the trading done based on illegal inside information. It is mainly concerned with raising the cost of capital for security issues. Insider trading impacts the investment behavior of investors which is evident from the scams in the past relating to reliance petroleum, Rajat gupta case and financial crisis in U.S.A. in 2008. The repercussions of these issues can be discussed as: Loss of faith in the exchange market as publicly traded companies rely on large number of people to purchase share of their stock and such faithlessness can lead to huge losses for companies., Public often are lured to buy huge amount of stock in hope of large dividends where as it would not end up being so. Along with the negative effects there are positive effects too, as it acts as a price accelerator and brings the price of the securities to their proper level more quickly. The paper will be case based related to the previous scams based on the relevant topic. Insider trading as a practice that market can do without it however it also acts as a very helpful tool, the research paper will map the effects of insider trading on investor behavior and will also analyze the risk aversion that drives them towards taking conservative investment decisions. Insider trading has always and will always be a mysterious force behind all the decisions taken by investors in their investments.

Keywords: insider trading, risk aversion, investors.

I. INTRODUCTION

Prologue to Insider trading:

Insider trading is the buying or selling of a public company's stock or other securities (such as bonds or stock options) by individuals with access to non-public information about the company. In various countries insider trading based on inside information is illegal. This is because it forms a bias for other investors who do not have access to the information .According to some professionals illegal insider trading raises the cost of capital for securities issuers, thus decreases the overall economic growth. However, others have argued that insider trading should be allowed and could, in fact, benefit markets. Markets are sensitive to the news and events followed by the reactions of the investors. The overall ordeal states that there exists a strong relationship between the market sentiments and the events. The paper tries to review few instances which had proved that as to how insider trading has affected the investor’s attitudes.

The Objective of the paper is to review:

- The effect of insider trading on the goodwill of companies.
- As to whether insider trading has a positive or a negative impact on investors’ investment behavior.
- The economic indicators that lead to insider trading.

Methodology:

The paper is descriptive and conceptual in nature. The paper reviews the literature related to insider trading issues at international and national level supported by case study in both the context. Secondary data has been used extensively from varied sources to arrive at inferences and conclusions.

Characterization of "Insider":

In the United States and Germany, for mandatory reporting purposes, corporate insiders are defined as a company's officers, directors and any beneficial owners of more than 10% of a class of the company's equity securities. Trading by specific insiders, such as employees, is commonly permitted as long as it does not rely on material information not in the public domain. However most jurisdictions require such trading be reported so that these can be monitored. In the United States and several other jurisdictions, trading conducted by corporate officers, key employees, directors, or significant shareholders must be reported to the regulator or publicly disclosed, usually within a few business days of the trade.

In Indian context Insider trading can be defined as a malpractice wherein trade of a company's securities is undertaken by people who by virtue of their work have access to the otherwise nonpublic information which can be vital for making investment decisions.

Derivation of Insider trading:

The first "Insider trading" case was reported in the US way back in 1792.William Duer, the then assistant secretary in the US department of treasury used his official position to gather insider knowledge and involved in speculative trading in the newly issued debt of the US government. He was indicted and spent his days behind bars.

In the early 1920s JP Morgan & Co. used its high influence with Republican Party to make huge profits from central bank of US which led to an unprecedented boom in NYSE and consequently the selloff started plunging the prices to new lows and triggering a panic among investors and banks. This chaotic economic scenario led into the decade long great depression.

It was after the great depression that the public demanded for tough laws on insider trading done to manipulate profits. In 1964 the Securities Act Amendment laid down disciplinary controls over brokers and dealers. Since, then a study of 103 countries that have stock market revels that insider trading laws exists in 87 of them, however enforcement has taken place in only 38 of them.

Insider trading has continued till recent times and we have seen a series of lawsuits being filed for internal trading and fraudulent trade practices.

Investor's perception:

The bulk of research in modern economics has been built on the notion that human beings are rational agents who attempt to maximize wealth while minimizing risk. These agents carefully assess the risk and return of all possible investment options to arrive at an investment portfolio that suits their level of risk aversion. If some traders are better informed than others, then the market-maker in a security experiences an adverse selection problem. If he were to set a single price to buy and sell any amount of securities on demand, on average, he would neither gain from nor lose to uninformed investors, since trading by uninformed investors is not related to abnormal future stock price movements by definition. However, he would systematically lose to the informed traders.

He would inadvertently buy stock from the informed traders prior to abnormal stock price declines and sell stock to the informed traders prior to abnormal stock price increases, thereby resulting in inventory positions that are negatively correlated with future abnormal stock price movements. So, outside investors cannot use the publicly available information about insiders' transactions to earn abnormal profits.

II. Case of Insider Trading

A. Reebok-Adidas merger- International Perspective

David Pajcin was a Croatian trader who met Eugene Plotkin when both were employees of the investment bank Goldman Sachs. In 2004, Plotkin introduced Pajčin to his friend Stanislav Shpigelman, a Merrill Lynch investment banker, at a Russian day spa in lower Manhattan. Pajcin knew Jason Smith, a postal worker, from high school and was romantically involved with Monika Vujovic, also a Croatian immigrant who worked as an exotic dancer. Shpigelman provided Pajčin and Plotkin with tips on upcoming mergers and acquisitions in return for payoffs. The largest trades that netted the vast majority of the case's profits stemmed from a single tip from Shpigelman about the upcoming acquisition of Reebok by Adidas-Salomon AG.

In addition to trading on tips from Shpigelman, Pajcin also traded on confidential information from Jason Smith, his high school friend, who was serving on a grand jury, and on non-public information from advance copies of Business Week provided by warehouse workers Nickolaus Shuster and Juan Renteria, who were paid by Pajcin and Plotkin for that information. Pajcin placed trades in his own account and in the accounts of his aunt, Sonja Anticevic, and his girlfriend, Monika Vujovic, based on these tips. In addition, a number of other individuals, most of them Croatian nationals, placed trades based on tips received by Pajcin and Plotkin from their inside sources. The US Securities and Exchange commission (SEC) started investigating the case and announced charges on Eugene Plotkin and David Pajcin on the grounds of international schemes of serial insider trading.

Summary of the Commission's Complaint:

Plotkin and Pajcin explored a variety of audacious insider-trading schemes. Among others, Plotkin and Pajcin met with a series of individuals employed at various investment banks in an attempt to get them to provide non-public information about deals those banks were handling. They even asked them to come to pajcin's girlfriend's exotic dances to induce investment bankers to provide Plotkin and Pajcin with information. At least two schemes were consummated.

The Merrill Lynch Scheme

The complaint alleges that Plotkin and Pajcin infiltrated the investment banking unit of Merrill Lynch, repeatedly learning of mergers and acquisitions transactions before they became public. In exchange for a share of the illegal profits, Stanislav Shpigelman, an analyst at Merrill Lynch, leaked confidential information to defendants Plotkin and Pajcin concerning at least six mergers or acquisitions that Merrill Lynch was working on, prior to the time the deals became public, including deals between:

1. The Proctor & Gamble Company and the Gillette Company.
2. Novartis AG and Eon Labs, Inc.
3. Duke Energy and Cinergy Corp.
4. Quest Diagnostics, Inc. and LabOne, Inc.
5. Celgene Corp. and a company considering acquiring Celgene; and
6. Reebok and adidas.

Plotkin and Pajcin traded on the insider information and passed the insider information on to individuals in the United States and Europe (Traders) who traded on it. Plotkin and Pajcin had an agreement with the Traders, pursuant to which they were to receive a percentage of the illicit profits made by the Traders. The Merrill Lynch Scheme yielded over $6.4 million in illicit trading profits.

The BusinessWeek Scheme:

The complaint further alleges that Plotkin and Pajcin also infiltrated one of the printing plants utilized by BusinessWeek, repeatedly obtaining advance copies of the market-moving Inside Wall Street (IWS) column in BusinessWeek. Plotkin and Pajcin recruited two individuals first, Nickolaus Shuster, and later Juan C. Renteria, Jr. to obtain employment at Quad/Graphics, Inc., one of four printing plants that print BusinessWeek magazine, for the sole purpose of stealing copies of upcoming editions of the magazine, and calling Plotkin or Pajcin to read them key portions of IWS- a widely-read column in the magazine that generally moves the price of the securities of companies mentioned in it prior to the time the column became available to the public. The complaint alleges that Shuster and Renteria provided Plotkin or Pajcin with insider information concerning at least twenty companies that were featured in the IWS column. Plotkin and Pajcin then either traded on the IWS insider information or passed the information to some or all of the traders, who traded on the insider information. The BusinessWeek Scheme yielded over $345,000 in illicit trading profits. On Aug. 5, 2005, within 48 hours after the announcement of the Reebok-adidas merger, the Commission obtained a court order from the United States District Court for the Southern District of New York freezing a securities account in the name of Sonja Anticevic, Pajcin's aunt. The Commission sought additional emergency relief on Aug. 18, 2005, related to the Reebok trading against 8 additional defendants. As a result, the Court ultimately entered preliminary injunction against all of the defendants, and the Commission obtained Court orders freezing over $6 million in illegal profits stemming from insider trading in Reebok securities.

Exhibit A

Defendants' Trading in Connection With Non-Public Merrill Lynch Mergers and Acquisitions Deals

Name	Date	Action	Symbol	Description
David Pajcin	1/26/05 - 1/27/05	Buy	G	38 buy transactions were placed to purchase a total of 346 call options and 3,000 shares
	1/27/2005	Announcement		P&G acquiring Gillette
David Pajcin	1/28/2005	Sell	G	28 sell transactions were placed to sell all 346 call options and all 3,000 shares
David Pajcin	2/17/2005	Buy	ELAB	65 buy transactions were placed to purchase a total of 50 call options and 21,000 shares
	2/21/2005	Announcement		Novartis to Buy Hexal, Eon Labs for $8.3 Billion Cash
David Pajcin	2/22/2005	Sell	ELAB	30 sell transactions were placed to sell all 50 call options and all 21,000 shares
David Pajcin	5/4/05 - 5/6/05	Buy	CIN	29 buy transactions were placed to purchase a total of 645 call options and 2,000 shares
	5/9/2005	Announcement		Duke Energy Agrees to Acquire Cinergy
David Pajcin	5/9/2005	Sell	CIN	24 sell transactions were placed to sell all 645 call options and all 2,000 shares
Ilja Borac	5/6/2005	Buy	CIN	3 buy transactions were placed to purchase 15,000 shares
	5/9/2005	Announcement		Duke Energy Agrees to Acquire Cinergy
Ilja Borac	5/9/2005	Sell	CIN	3 sell transactions were placed to sell all 15,000 shares
Sonja Anticevic	8/1/05 - 8/2/05	Buy	RBK	33 buy transactions were placed to purchase a total of 1,997 call options and 240 shares
	8/3/2005	Announcement		Adidas to Acquire Reebok
Sonja Anticevic	8/3/2005	Sell	RBK	30 sell transactions were placed to sell all 1,997 call options and all 240 shares
Henry Siegel	8/1/05 - 8/2/05	Buy	RBK	48 buy transactions were placed to purchase a total of 1,180 call options and 8,000 shares
	8/3/2005	Announcement		Adidas to Acquire Reebok
Henry Siegel	8/3/2005	Sell	RBK	60 sell transactions were placed to sell all 1,180 call options and all 8,000 shares
Elvis Santana	8/1/05 - 8/2/05	Buy	RBK	6 buy transactions were placed to purchase a total of 465 call options and 520 shares
	8/3/2005	Announcement		Adidas to Acquire Reebok
Elvis Santana	8/3/2005	Sell	RBK	13 sell transactions were placed to sell all 465 call options and all 520 shares
Direktanlage Traders	8/2/2005	Buy	RBK	1 buy transaction was placed to purchase a total of 7,545 shares
	8/3/2005	Announcement		Adidas to Acquire Reebok
Direktanlage Traders	8/3/2005	Sell	RBK	1 sell transaction was placed to sell all 7,545 shares
Monika Vujovic	8/1/2005	Buy	RBK	5 buy transactions were placed to purchase a total of 455 call options
	8/3/2005	Announcement		Adidas to Acquire Reebok

Monika Vujovic	8/3/2005	Sell	RBK	3 sell transactions were placed to sell all 455 call options
Mikhail & Marina Plotkin	8/2/2005	Buy	RBK	3 buy transactions were placed to purchase a total of 60 call options and 120 shares
	8/3/2005	Announcement		Adidas to Acquire Reebok
Mikhail & Marina Plotkin	8/3/2005	Sell	RBK	7 sell transactions were placed to sell all 60 call options and all 120 shares
Ilja Borac	8/1/05 - 8/2/05	Buy	RBK	9 buy transactions were placed to purchase a total of 50,000 shares
	8/3/2005	Announcement		Adidas to Acquire Reebok
Ilja Borac	8/3/2005	Sell	RBK	9 sell transactions were placed to sell all 50,000 shares
Zoran Sormaz	8/1/05 - 8/2/05	Buy	RBK	6 buy transactions were placed to purchase a total of 40,000 shares
	8/3/2005	Announcement		Adidas to Acquire Reebok
Zoran Sormaz	8/3/2005	Sell	RBK	6 sell transactions were placed to sell all 40,000 shares
Perica Lopandic	8/1/05 - 8/2/05	Buy	RBK	7 buy transactions were placed to purchase a total of 55,000 shares

Exhibit B

Defendants' Trading in Connection With Non-Public Business Week Contents

Date	Action	Symbol	Description
12/16/2004	Buy To Open	ATAL	14 buy transactions were placed to purchase a total of 370 call options
12/17/2004	Inside Wall Street	Alltel	Expecting a Call
12/17/2004	Sell To Close	ATAK	4 sell transactions were placed to sell all 370 call options
1/20/2005	Buy	ARB	9 buy transactions were placed to purchase a total of 3,500 shares
1/21/2005	Inside Wall Street		The Dutch may tune in Arbitron
1/21/2005	Sell	ARB	5 sell transactions were placed to sell all 3,500 shares
1/20/2005	Buy	ARB	2 buy transactions were placed to purchase a total of 18,400 shares
1/21/2005	Inside Wall Street		The Dutch may tune in Arbitron
1/21/05 - 1/25/05	Sell	ARB	4 sell transactions were placed to sell all 18,400 shares
11/18/2004	Buy	BLTIE	12 buy transactions were placed to purchase a total of 6,000 shares
11/19/2004	Inside Wall Street		Will More Dentists Ask for Biolase Drills?
11/19/2004	Sell	BLTIE	13 sell transactions were placed to sell all 6,000 shares
11/18/2004	Buy	BLTIE	1 buy transaction was placed to purchase 76,000 shares
11/19/2004	Inside Wall Street		Will More Dentists Ask for Biolase Drills?
11/19/04 - 11/23/04	Sell	BLTIE	3 sell transactions were placed to sell all 76,000 shares
6/16/2005	Buy	CMRG	3 buy transactions were placed to purchase a total of 21,000 shares
6/17/2005	Inside Wall Street		The Big and Tall Stride Into Casual Male
6/17/2005	Sell	CMRG	11 sell transactions were placed to sell all 21,000 shares
6/16/2005	Buy	CMRG	3 buy transactions were placed to purchase a total of 2,035 shares
6/17/2005	Inside Wall Street		The Big and Tall Stride Into Casual Male
6/17/2005	Sell	CMRG	1 sell transaction was placed to sell all 2,035 shares
6/16/2005	Buy	CMRG	2 buy transactions were placed to purchase a total of 40,200 shares
6/17/2005	Inside Wall Street		The Big and Tall Stride Into Casual Male
6/17/2005	Sell	CMRG	2 sell transactions were placed to sell all 40,200 shares
12/2/2004	Buy	CRIS	27 buy transactions were placed to purchase a total of 10,000 shares
12/3/2004	Inside Wall		Rich Suitors May Come Courting Curis

	Street		
12/2/2004*	Sell	CRIS	*In after hours trading, a total of 12 sell transactions were placed to sell all 10,000 shares Exhibit B

The Commission alleged that, as a result of trading in various securities on the basis of material, non-public information obtained pursuant to the Merrill Lynch Scheme or the BusinessWeek Scheme, the defendants engaged in illegal insider trading in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. In addition, the Commission alleges that defendants Plotkin, Pajcin, and Shpigelman violated Section 14(e) of the Exchange Act and Rule 14e-3 thereunder by trading in the stock of a company while in possession of material, non-public information related to a cash tender offer for such company's stock. Among other things, the complaint seeks permanent injunctive relief, the disgorgement of all illegal profits plus prejudgment interest, the imposition of civil monetary penalties, and orders requiring the defendants to repatriate to the United States proceeds of the fraud in accounts outside the United States.

More than $6 million, meaning nearly all of the profits from the conspiracy were secured by federal authorities who immediately moved to freeze bank accounts when the fraud was discovered. Pajčin was arrested in 2005 and cooperated with the government. Subsequently, all of his co-conspirators were arrested in 2006. After pleading guilty to charges in the case in 2008, Pajcin was sentenced to time served. Several months after his release, Pajcin broke the terms of his probation and fled the United States. A warrant was issued for his arrest in April 2008. In 2010, Pajcin was ordered to pay a $7.7 million default judgment and $20.8 million in fines to the SEC. Plotkin pleaded guilty to conspiracy to commit securities fraud and eight counts of insider trading. In 2008, he was sentenced to 57 months imprisonment and ordered to pay a $10,000 fine. Shpigelman pleaded guilty to conspiracy to commit securities fraud and insider trading. In 2007, he was sentenced to 37 months imprisonment. Smith pleaded guilty to felony criminal contempt. In 2006, he was sentenced to 33 months imprisonment and ordered to pay a $6,000 fine. Shuster pleaded guilty to conspiracy to commit securities fraud and insider trading. In 2008, he was sentenced to time served. Renteria pleaded guilty to conspiracy to commit securities fraud and insider trading. In 2008, he was sentenced to 2 years' probation.

Based on the analysis of the given case following conclusions can be derived:

Background note

- Shpigelman gave David Pajcin and Eugene Plotkin tips on upcoming M&A.
- Pajcin traded on confidential information from Jason Smith.
- Jason Smith got information from advance copies of Business Week.
- Information warehouse workers Nickolaus Shuster and Juan Rentria.

Effects

- Passed Insider information to individuals in US and Europe especially traders.
- Agreement with the traders to receive a percentage of illicit profits.
- Obtained advance copies of Business Week which gave them information of minimum 20 companies.

Conclusions

- Merrill Lynch scheme yielded illicit trading profit of $6.4 million.
- Business Week yielded trading profit of $3,45,000.
- $6 million profits were secured by federal authorities and bank accounts were ceased.
- Plotkin and Pajcin were found guilty of fraud.

B. Rajat Gupta's Case On insider trading- Indian Perspective:

Rajat Gupta was viewed as a master networker, establishing relationships through his philanthropy with Mr. Clinton, Microsoft Corp. co-founder Bill Gates and Hank Paulson, the former Goldman CEO and Treasury Department secretary. Mr. Gupta and his wife were among the list of invited attendees to President Barack Obama's first state dinner, according to a list released by the White House. It was through the creation of the Indian School of Business in Hyderabad in the late 1990s that Mr. Gupta met the man who would help bring about his downfall. A mutual friend, Anil Kumar, asked for donations from Raj Rajaratnam, founder of the Galleon Group hedge fund, who pledged $1 million, according to testimony at Mr. Gupta's trial. Mr. Rajaratnam was convicted of insider trading last year and sentenced to 11 years in prison. Mr. Kumar, who was Mr. Gupta's protégé at McKinsey, pleaded guilty to giving the Galleon chief unrelated tips, testified at both men's trials and recently received a sentence of probation. Messrs. Rajaratnam and Gupta became friends. The ability to cultivate contacts, along with their South Asian heritage, was a quality Mr. Gupta shared with the 55-year-old Mr. Rajaratnam, a Sri Lankan native. Gupta and Rajaratnam had vastly different personal styles. The square-jawed Mr. Gupta was quiet and distinguished; Mr. Rajaratnam was rougher around the edges and enjoyed practical jokes, people who know them said. Though Mr. Gupta had a more public persona, the billionaire Mr. Rajaratnam was far richer.

Mr. Gupta often would have lunch with Mr. Rajaratnam in the hedge-fund manager's office, ordering Indian or Chinese food. Starting around 2003, he and Mr. Rajaratnam began investing millions of dollars together, according to court documents from his trial, both in vehicles related to Galleon and in an Asia-focused private-equity fund Mr. Gupta had helped to start. In the ensuing years, Mr. Gupta leaked Mr. Rajaratnam inside information, both because of their friendship and business dealings, prosecutors said. They said Mr. Gupta became a "secret pipeline" to Mr. Rajaratnam from 2007 until early 2009 for inside information on the boards of Goldman and Procter & Gamble Co.

Disclosure of Berkshire's $5 Billion Investment in Goldman Sachs:

Gupta disclosed to Rajaratnam material nonpublic information regarding the $5 billon investment of Berkshire's in Goldman Sachs before it was publicly announced on September 23, 2008. This information made Galleon Tech funds to purchase 40,000 additional shares of Goldman Sachs. Goldman Sachs publicly announced the Berkshire investment, along with a $2.5 billion public stock offering, after the market close on September 23. Goldman Sachs's stock price, which had closed at $125.05 per share on September 23, opened at $128.44 per share the following day and rose to a closing price that day of $133.00 per share, a gain of 6.36% from the prior day's closing price. On September 24, Rajaratnam caused the Galleon Tech funds to liquidate the long position they had built on September 23, generating profits of over $900,000.

Disclosure of Goldman Sachs's Financial Results for the Fourth Quarter of 2008:

When Goldman Sachs announced negative results for the fourth quarter of 2008 on December 16, 2008, reporting a $2.1 billion loss, its first (and only) quarterly loss as a publicly traded company, Rajaratnam caused the Galleon Tech funds to begin selling their holdings of Goldman Sachs stock. The funds finished selling off their holdings which had consisted of over 120,000 shares, that same day at prices ranging from $97.74 to $102.17 per share. Thus Rajaratnam avoided losses of over $3 million.

Disclosure of Procter & Gamble's Financial Results for the Quarter Ending December 2008:

Procter & Gamble's pre-market quarterly earnings release was issued, on January 29, 2009.

A draft of these earnings was mailed to Gupta 2 days before and the draft also stated that the company expected organic sales, or sales related to preexisting rather than newly acquired business segments, to grow 2-5% in the fiscal year. This compared negatively to the 4-6% growth the company had previously publicly predicted. When Gupta passed this information to Rajaratnam, Galleon funds sold approximately 180,000 Procter & Gamble shares. By virtue of their trades, which were based on the material nonpublic information that Gupta provided to Rajaratnam, the Galleon funds generated illicit profits of over $570,000.

Based on the analysis of the given case following conclusions can be derived:

Backgroundnote	**Effects**	**Conclusions**
• Rajat Gupta traded about the Berkshire's investment in Goldman Sachs to Rajaratnam. (Galleon Hedge Fund Founder) • He also disclosed the financial Results of fourth quarter. • He also disclosed the P&G's financial results.	• Gupta tips allowed Rajaratnam to earn millions of dollars. • $5 million investment of Berkshire increased the share price of Goldman Sachs to $133 per share(6.33% gain). • In 4Q Goldman Sachs reported a loss of $2.1 billion declining the share prices to 97.4 per share.	• Mr. Gupta was banned from serving as director of a public company and was sentenced to prison for 2 years. • Mr. Gupta was fined $ 13.9 million. • Galleon Funds generated illicit profits of $570000.

III. Role of Securities and Exchange Board of India as Regulator

The Securities and Exchange Board of India (SEBI) has amended The Securities and Exchange Board of India (Insider Trading) Regulations, 1992 and after amendment in 2002 renamed the same as The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 1992 (hereinafter called the „Regulations‟). It has modified the various Regulations making it wider for coverage and more stringent for its compliance. All Directors and all Members of Staff of the Company are covered under the provisions of The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 and the regulations shall be complied with to the extent applicable.

The prevention of Insider trading:

- Compliance Officer: SEBI has asked companies to appoint a compliance officer who shall report the Managing director/Chief Executive Officer. The Compliance Officer shall be responsible for setting forth policies, procedures, monitoring adherence to the rules for the preservation of "Price-sensitive Information", pre-clearing of "Designated Employees‟ and their dependent trades (directly or through respective department heads as decided by the Company), monitoring of trades and the implementation of the code of conduct under the overall supervision of the Board of the Company.

  Explanation - The term, Designated Employee‟ shall mean all employees and the Directors of the company.

- Preservation of price sensitive information: SEBI has clearly mentioned that the price sensitive information should be given to the employees on "NEED TO KNOW" basis and those employees should not pass this information to any person outside the company. The files containing price sensitive information should be kept confidential having adequate security.

- Prevention of misuse of price sensitive information: The Company should specify a trading period called as "trading window" for trading in company's securities and should not access trading window until the information gets published. During declaration of financial results, dividends, issue of securities, amalgamation or merger decisions and et cetera.

- Preclearance of trades: Those intend to deal in securities of the company should pre-clear the transactions as an application form –III should be filled stating all the details of the securities the employee wants to deal with. The company's responsibility is that the employee should not know any information till he/she has filled up the application form. In case of sale of securities is necessitated by personal emergency, an application for waiving the minimum period of 30 days should be made to the compliance officer.

- Reporting requirements of transactions in securities: All designated employees of the company shall be required to forward the following details of their securities transaction to the compliance officer.
- Penalty for contravention of code of conduct: Any designated employee who trades in securities or communicates any information for trading in securities in contravention of the code of conduct must be penalized and appropriate action must be taken by the company which may include wage freeze, suspension, and ineligible for future participation in employee stock option.
- Information to SEBI in case of violation of SEBI regulation, 1992: In case of it is observed by the company. Compliance officer that there has been a violation of SEBI regulation, 1992.SEBI shall be informed by the company.
- Sebi plans to curb on promoters trades: Sebi said that insiders have to specify a window in dealing with shares and aimed at providing transparency. Promoters and other company insiders have to disclose the stock exchange information within 5 days of trade. Sebi is also looking at optimizing the regulator's newly gained powers, such as those of search and seizers, to crackdown on insider trading.

REPERCUSSIONS OF INSIDER TRADING ON THE INVESTMENT DECISIONS:

Many professional like broker-dealers, securities analysts, floor traders and institutional investors finds insider trading beneficial because they are "next in line" for trading profits, as they possess an advantage over public investors in collecting and analyzing information. Managers choose to invest in risky projects as they know about how the uncertainty can be resolved. Greater uncertainty helps them earn more trading profits. However the effectiveness of the insider trading prohibition and the commitment to enforcing it has been low in most countries. Many researchers argue that trading on inside information is a zero-sum game, benefiting insiders at the expense of outsiders. But most outsiders who bought from or sold to insiders would have traded anyway and possibly at a worse price. The impact of illegal insider trading is considered negative for both the small investors and for the markets. Illegal insider trading ensures that there is no fair play involved and there is no fair demand and supply of stocks, all detrimental to the functioning of a healthy capital market. Illegal insider trading weakens the faith of investors in the investing system and an unchecked insider trading could keep off people from investing capital and this could potentially harm the economy as a whole. So as an investor, we should be cautious to avoid getting into the marsh of insider trading scams. Never invest in a company or an industry that you have never heard of even if you get a tip-off.

IV. Conclusion

The research paper maps the effects of insider trading on investor behavior and analyzes the risk aversion that drives them towards taking conservative investment decisions. Insider trading has always and will always be a mysterious force behind all the decisions taken by investors in their investments. The paper pinpoints that insider trading has negative implications on the investment behavior of the investors as well is harmful for the organization. Solid framework of regulatory measures may enable in strict vigilance against insider trading in India. A strong regulatory framework backed up with good internal governance code within the organizations will enable business entities to reduce the instances of insider trading.

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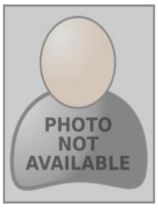
AUTHOR(S) PROFILE



Dr. Deepa Pillai is Associate Professor at Indira Institute of Management, Pune affiliated to University of Pune. She is a Post Graduate in Commerce and Associate Member of the Institute of Cost Accountants of India. She has an experience of 10 years teaching finance subjects at post graduate level.

Shayan Kar is currently pursuing his MBA degree from Indira Institute of Management, Pune and has completed his BCA from Maharashtra Institute of Technology, Pune. He is an unhinged Manchester United fan and a sports enthusiast. He is an avid reader. His research interests are Behavioral finance, Asset pricing, Risk management, corporate finance and financial market.

Rutvika Shah is pursuing her MBA degree from Indira Institute of Management, Pune. She has completed her Engineering in Electronics.