THE WALL STREET JOURNAL.
WSJ.com

April 21, 2014, 5:54 PM IST

Why is it Tough to Catch Insider Trading in India?

ByKenan Machado

The Bombay Stock Exchange building in Mumbai, March 7.
Indranil Mukherjee/Agence France-Presse/Getty Images

India needs better investigative powers and tools to combat insider trading, says some analysts and former regulators.

When a stock soars or plunges for no apparent reason in India, analysts and investors usually assume the shares are moving on information that is not yet public. However despite the widespread belief in regular insider trading, there are few examples of insider traders getting prosecuted here.

While insider trading is tough to detect and prove in any country, in India it seems to be particularly rampant because regulators just don't have the tools to keep it in check, said J.N. Gupta, a former director of the Securities and Exchange Board of India.

"All the participants, including regulatory bodies, are aware that insider trading is deeply rooted in our market," Mr. Gupta–who is now the chief executive of Stakeholders Empowerment Services, a research and advisory firm–told The Wall Street Journal.

A SEBI spokesman did not respond to requests for the regulator's reaction to concern it needs more powers to better battle insider trading.

The Securities and Exchange Board of India has been asking for more powers but has only recently been allowed to even look at phone records of the investors it is investigating. In July, the government started allowing SEBI to access the phone-company records of calls made. But SEBI is still not allowed to use wire taps which have been crucial to exposing insider trading in other countries.

Insider traders are often able to stay a step ahead of investigators, said one former SEBI official who asked not to be named.

The regulator uses software to aggregate all the trades connected to related companies, individuals and mailing addresses but insider traders just use dummy firms at different addresses, the former SEBI official said. When SEBI started tracking trades using investors' tax identification numbers called Personal Account Numbers, insider traders just switched to the PAN numbers of relatives, friends or colleagues, the former official said.

"There is no fear of regulation in market participants," said Shriram Subramanian, founder of InGovern, a corporate governance research firm.

In the few cases where SEBI has been able to get enough evidence to prosecute, the court cases have sometimes taken more than a decade to make their way through India's overburdened court system.

Meanwhile, even if insider traders are caught and found guilty after long trials, the punishments have often been too light to offset the potential profits.

While by law SEBI has the ability to demand penalties of up to around $4 million, the few fines that have been handed down for insider trading have usually been less than $200,000, according to a report by Mumbai-based law firm Nishith Desai Associates.

India needs to be tough in insider traders like the U.S., said Mr. Subramanian of InGovern.

In October 2011, a U.S. district judge ordered a 11-year prison sentence, forfeiture of $53.8 million and a fine of $10 million on hedge fund manager Raj Rajaratnam, who allegedly benefited by trading on insider information in the U.S.

"People should be made bankrupt or sent to jail," Mr. Subramanian said.

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