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"Insider trading should be a civil offence"

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INTERVIEW

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On September 24, Sebi reconfirmed its earlier order debarring Samir Arora, the ex-chief investment officer of Alliance Capital Mutual Fund, from dealing in securities on charges on insider trading, unethical trade practices and violation of disclosure norms.

Jayanth R Varma

The Sebi ruling has raised several fundamental questions about whether the approach to nailing insider trading is correct. **Jayanth R Varma**, professor, Indian Institute of Management, Ahmedabad, shares his views on the effectiveness - or ineffectiveness - of the current approach to curbing insider trading and how it can be tackled.

Varma, who was an executive director with Sebi earlier, was instrumental in kicking of derivatives trading in India.

On whether the current insider trading regulations protect the interest of small shareholders

I believe that the proper response to insider trading is to force the offenders to compensate other investors for the losses suffered by them due to insider trading.

Investors should be allowed to recover not only the actual damages but also punitive (say triple) damages both as a deterrent to insiders and as a recompense for their own efforts. Sending the insider to jail or stopping him from trading does nothing to recompense the suffering investors.

Therefore, insider trading should be a civil offence rather than a criminal offence and the right to initiate proceedings for this should lie not with the regulators but with the investors themselves.

On whether the current approach to tackling insider trading is effective enough

The current approach to tackling insider trading is fatally flawed. Regulators worldwide have proved themselves incapable of doing the job. Insider trading is notoriously difficult to prove.

Regulators, therefore, seek extraordinary powers to compensate for the weakness of evidence.

However, regulators have rarely used their powers judiciously and have always tended to pursue specific high-profile cases for extraneous reasons.

The most famous insider trading case in the US (Ivan Boesky) is a good example. The most serious offender, Ivan Boesky, went virtually scot-free; Mike Milken went to jail on minor offenses unrelated to insider trading and the prosecutor, Rudy Guilliani, used the case to launch a very successful political career.

In the boardrooms of America there was a sigh of relief that hostile takeovers had been curbed and investors were left licking their wounds.

The fact is that criminal prosecution of insider trading may benefit politicians and would-be politicians but does not benefit investors. This is as true (or perhaps even more true) in India as in the US.

On whether disclosures are adequate in India

I think we should have as complete a disclosure as possible. With modern technology, the quarterly reporting cycle is more or less obsolete and we must consciously move towards a real-time reporting of key financial information. There would then be little need for quiet periods.

And if investors are to be empowered to sue for insider trading, they need the information on the basis of which they can detect and establish insider trading.