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Insider Trading Allegations in the HDFC-HDFC Bank Merger and an Analysis of SEBI's Recent Settlements

BIRAJ KRISHNA BHATTACHARYA¹ AND SURAJ PATRA²

ABSTRACT

This article examines the notion of insider trading in the context of the HDFC Ltd.-HDFC Bank merger in India. It discusses how the improper use of Unpublished Price Sensitive Information (UPSI) during corporate deals undermines market integrity and erodes investor confidence. The situation involving a Deloitte employee and his associates illustrates SEBI's regulatory framework and its enforcement actions under the SEBI Act and the 2015 Insider Trading Regulations. It outlines the investigative procedure, sanctions, and settlement approaches implemented by SEBI. The article also underscores the legal, ethical, and governance ramifications of insider trading and suggests enhancements such as advanced digital monitoring systems, employee education, and the incorporation of best global practices to boost transparency, to prevent future infringements, and fortify India's financial regulatory landscape.

Keywords: Insider trading, HDFC-HDFC Bank merger, SEBI.

I. INTRODUCTION

Imagine this I am your friend working in a big financial company named xyz Ltd. That assists companies with mergers and acquisitions. I came across a confidential email that states the company is going to be part of a merger with another company. This information is not public and investors in the market are unaware of it since it would be announced publically in a week. And I leak this information to you after which you buy multiple shares of xyz Ltd. After a week when the merger is announced and the stock prices of xyz Ltd increase you sell your shares to make a tremendous profit this, my friend is insider trading and is illegal under the laws in India. What makes it illegal? It is a violation of the principle of equality. Investors in the market should act on publically disclosed information and not rely on insiders to get an unfair advantage over others.

The buying and selling of a company's publically traded shares by an individual who is an

¹ Author is a student in India.

² Author is a student in India.

insider in the company and has access to certain undisclosed price-sensitive information related to the company is known as insider trading.

II. OVERVIEW OF THE HDFC MERGER

Housing Development Finance Corporation (HDFC) merger with HDFC Bank, taking effect on July 1, 2023, is a watershed in India's financial past. The nearly \$40-billion all-share deal combines HDFC's decades of mortgage lending experience with HDFC Bank's stable banking operations to form a finance giant that will revolutionize banking not just in India but worldwide.

The consolidated entity has a strong balance sheet with consolidated assets of over ₹18 lakh crore to be India's second-largest bank by size after the State Bank of India alone. In the globe, the combined institution is the fourth-largest bank in terms of market capitalization, replacing other global banking titans like Citigroup and HSBC.

With about 120 million customers, over 8,300 branches, and over 177,000 staff, the union effectively enhances the coverage and capability of the bank to conduct operations. Strategically, the mergers aim to leverage synergies between the two institutions. HDFC Bank's technical capabilities and widespread distribution network with HDFC's established housing finance presence are expected to enable cross-selling opportunities and broaden the offerings of financial products to customers. The merger is seen to simplify operations, eliminate redundancies, and enable innovation in product offerings.

The merger has enhanced the systemic functioning of HDFC Bank in India. It has been tagged by the Reserve Bank of India as a Domestic Systemically Important Bank (D-SIB) and is exposed to a greater capital buffer to neutralize any resultant risk, given its increasing size. This rating emphasizes the significance of the bank in maintaining the stability of finances and its other role in ensuring that it adheres to strict rules.

HDFC-HDFC Bank merger is a revolutionary consolidation in Indian banking history that brings in a diversified financial institution with enhanced capabilities and expanded market outreach. The merger is likely to drive growth through operational efficiency, enhanced product offerings, and expanded market coverage, and also likely to pose issues of integration and regulation.

III. TIMELINE AND NATURE OF THE INSIDER TRADING ALLEGATIONS

In India government regulatory bodies like the Securities Exchange Board of India (SEBI) attempt to curb insider trading activities by ongoing monitoring and surveillance of unusual

market activity further they have established strict rules and regulations to identify and penalize such insider trading activities

Some of the laws that regulate insider dealing are the Securities and Exchange Board of India Act, 1992 (SEBI Act) and the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015. SEBI Act Section 12A categorizes it as being punishable under fraud or unfair trade practice, i.e., insider trading, and SEBI Act Section 15G stipulates a penalty of ₹10 lakh to ₹25 crore or three times of the profit made through such, whichever is higher.

The alleged insider trading in HDFC-HDFC Bank merger has generated significant concerns on abuse of information in high-value corporate transactions. The Securities and Exchange Board of India (SEBI) undertook a probe from November 1, 2021, to April 30, 2022, to determine whether any individual traded on Unpublished Price Sensitive Information (UPSI) regarding the merger.

At the forefront of the investigation were two men: Nimai Parekh, an employee with Deloitte Touche Tohmatsu India LLP, and his friend, Rahil Dalal. Parekh was a member of the valuation team at Deloitte that was contracted by HDFC Bank as the merger valuer on March 29, 2022. His job exposed him to confidential information about the merger from the date. SEBI has fixed the UPSI period as December 13, 2021, through and including April 4, 2022, the date of public announcement of the merger.

SEBI's probe revealed that Parekh had shared the UPSI with Dalal, who again relayed this piece of information to his father, Rupesh Dalal. Trading accounts indicated that Rupesh Dalal purchased call option contracts of HDFC Ltd. and HDFC Bank just before the news of the merger was announced and sold them afterwards, making profits of ₹5.67 lakh and ₹2.52 lakh, respectively.

Rather than contesting the allegations, Parekh and Dalal opted for settlement under SEBI's Settlement Proceedings Regulations, 2018. They had proposed amended terms of settlement, which were approved by SEBI's High Powered Advisory Committee on September 6, 2024. Parekh then deposited ₹39 lakh, and Dalal deposited ₹35 lakh as settlement fees, making a total of ₹74 lakh. SEBI's direction, dated December 20, 2024, ended proceedings against them subject to a rider that any fraud or breach of settlement terms would revive investigation. The case shows the over-riding necessity of maintaining corporate transactions private and stringent measures by the regulators to preserve market integrity.

IV. SEBI'S INVESTIGATION AND FINDINGS

The Securities and Exchange Board of India (SEBI) conducted a thorough investigation of

potential insider trading violations regarding the merger of HDFC Ltd. and HDFC Bank. The investigation, which took place between November 1, 2021, and April 30, 2022, aimed to find out whether anyone traded on Unpublished Price Sensitive Information (UPSI) about the merger, which was publicly disclosed on April 4, 2022.

Nimai Parekh, a former employee of Deloitte Touche Tohmatsu India LLP, was at the heart of SEBI's findings. Parekh was part of the valuation team that HDFC Bank employed on March 29, 2022, and gained access to merger confidential information. SEBI concluded the UPSI period to be between December 13, 2021, and April 4, 2022.

SEBI's inquiry revealed that Parekh informed his friend Rahil Dalal about this, who, in turn, shared this tip with his father Rupesh Dalal. Trading accounts indicated that Rupesh Dalal purchased call option contracts in HDFC Ltd. and HDFC Bank one day prior to the merger news and sold these later on, making profits of ₹5.67 lakh and ₹2.52 lakh respectively. Rather than contesting the charges, Parekh and Dalal settled under SEBI's Settlement Proceedings Regulations, 2018. They formed new terms of settlement, which were approved by SEBI's High Powered Advisory Committee on September 6, 2024. Parekh deposited ₹39 lakh, and Dalal deposited ₹35 lakh as settlement fees for ₹74 lakh. SEBI's order of December 20, 2024, closed proceedings against them on a rider that any misstatement or breach of settlement terms can revive the investigation.

V. SETTLEMENT MECHANISM AND TERMS

In handling the allegations of insider trading related to the merger between HDFC Ltd. and HDFC Bank, the Securities and Exchange Board of India (SEBI) utilized its settlement mechanism under the SEBI (Settlement Proceedings) Regulations, 2018. With such a mechanism, parties can resolve violations without admitting or denying the findings, which helps expedite the resolution process as well as conserve regulatory resources.

The matter involved Nimai Parekh, an ex-employee of Deloitte Touche Tohmatsu India LLP, and his friend, Rahil Dalal. Parekh was part of the valuation team of Deloitte which HDFC Bank engaged on March 29, 2022, and had access to Unpublished Price Sensitive Information (UPSI) about the merger. SEBI's investigation revealed that Parekh disclosed this UPSI to Dalal, who shared it with his father, leading to trades that capitalized on the impending merger announcement. These were against SEBI's Prohibition of Insider Trading (PIT) regulations.

Accepting the settlement, Parekh and Dalal submitted revised settlement proposals to SEBI. These were considered and endorsed by SEBI's High Powered Advisory Committee (HPAC) on 6 September 2024. Parekh accepted ₹39 lakh, and Dalal accepted ₹35 lakh, in all ₹74 lakh.

SEBI's December 20, 2024, order concluded the proceedings against them subject to the rider that any misstatement or breach of the settlement agreement would re-initiate the investigation. The system of settlement works to effectively address violations, deter future misuse, and uphold market integrity without the time taken between court hearings. The case corroborates SEBI's seriousness regarding enforcing compliance by means of methods balancing regulatory effectiveness with the principles of justice.

VI. LEGAL AND ETHICAL CONSEQUENCES OF INSIDER TRADING IN MERGERS

Insider trading, and especially in big-ticket mergers such as the merger of HDFC Ltd. with HDFC Bank, brings up serious legal and ethical concerns that undermine corporate governance, market integrity, and investor confidence. The Securities and Exchange Board of India (SEBI) has also built a good legal framework for dealing with such cases, primarily in the SEBI (Prohibition of Insider Trading) Regulations, 2015. It has also categorized an "insider" as any individual who is a connected person or has Unpublished Price Sensitive Information (UPSI).

The HDFC merger case provides a classic instance of ethical violations arising when insiders who have access to UPSI use such information for their benefit. Such actions not only constitute violations of regulatory requirements but also undermine the ethical basis of corporate conduct, resulting in loss of investor confidence and market instability. SEBI regulatory action attracts severe penalties for the crime of insider trading. The SEBI Act, 1992, under Section 15G provides that individuals convicted of insider trading can be directed to pay penalties not exceeding ₹25 crore or three times the profits so made, whichever is higher. The Companies Act, 2013, under Section 195, also declares insider trading a forbidden act with penal provisions for any violations.

To enhance compliance and prevent insider trading, SEBI mandates listed companies to have internal controls, including the maintenance of a structured electronic database of persons with whom UPSI is communicated, under Regulation 3(5) of the 2015 Regulations. These measures are designed to ensure transparency and accountability on the part of corporate entities.

Finally, insider trading based on mergers like the one between HDFC Bank and HDFC Ltd. acknowledges the compulsion of rigid legal frameworks and moral vigilance.

VII. CONCLUSION AND RECOMMENDATIONS

The insider trading charges in the HDFC-HDFC Bank merger are an indicator of the highest level of importance of effective regulatory policies and rigorous corporate governance procedures. These are not just events that threaten market integrity but also investor confidence,

implying the necessity of comprehensive measures of avoiding the abuse of Unpublished Price Sensitive Information (UPSI).

In India, the SEBI (Prohibition of Insider Trading) Regulations, 2015, are regulated by the Securities and Exchange Board of India (SEBI), which defines an "insider" as any individual who is a connected person or possesses UPSI. The rules under such regulations prohibit insiders from dealing in securities while they are in possession of UPSI, other than that such communication is in pursuit of lawful objects, in the carrying out of duties, or for compliance with legal requirements. In order to ease such regulations, SEBI directs maintenance of a Structured Digital Database (SDD) as per Regulation 3(5), which accounts for the name and address of the individuals to whom UPSI is disclosed, the type of information, and the time and date of disclosure. It is supposed to promote transparency and accountability towards processing sensitive information.

As an added measure of securing the regulatory process, there must be proper restrictions on the accessibility of UPSI. With tight control necessary in accessing UPSI, its delivery to the necessary levels within or out of companies will be safer to avoid unwanted information spread and usage.

Apart from this, the SDD will need to be equipped with advanced features such as time-stamping, audit trails, and tamper-proofing to accurately trace the UPSI flow. Such features allow tracking of information distribution or violations in real-time. Also, periodic auditing of the SDD can lift its effectiveness, keeping the database up-to-date and in regulatory compliance.

Organizations. Regular training sessions must be conducted through which employees can be reminded of keeping information secret and the legal implications of insider trading. Clear policies and processes for handling UPSI can enhance the ethical drive of the organization and deter potential offenders.

Apart from this, SEBI could also consider implementing some of the global best practices in order to reinforce its regulatory framework. As an example, the U.S. Securities and Exchange Commission (SEC) employs Rule 10b5-1 plans whereby insiders are allowed to make pre-set trading plans, which will act as a defence for allegations of insider trading. But these plans can be employed improperly to set off severe sanctions, and hence there has to be strict control.

Including such practices in SEBI will help deter insider trading even more and uphold market integrity.

Last but not least, the HDFC-HDFC Bank merger case serves as a reminder of systemic frailties and the frightening implications of insider trading. With stringent access controls, tightening

the SDD, inculcating a good ethics-based corporate culture, and adhering to global best practices, India can make its armour impenetrable against insider trading. All these sweeping actions are essential to preserve investor confidence and keep the financial markets unfazed.

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