The Big News
What Is Front Running? SEBI Says Market Manipulation & Insider Trading

Why in the News?

AXIS ASSET MANAGEMENT

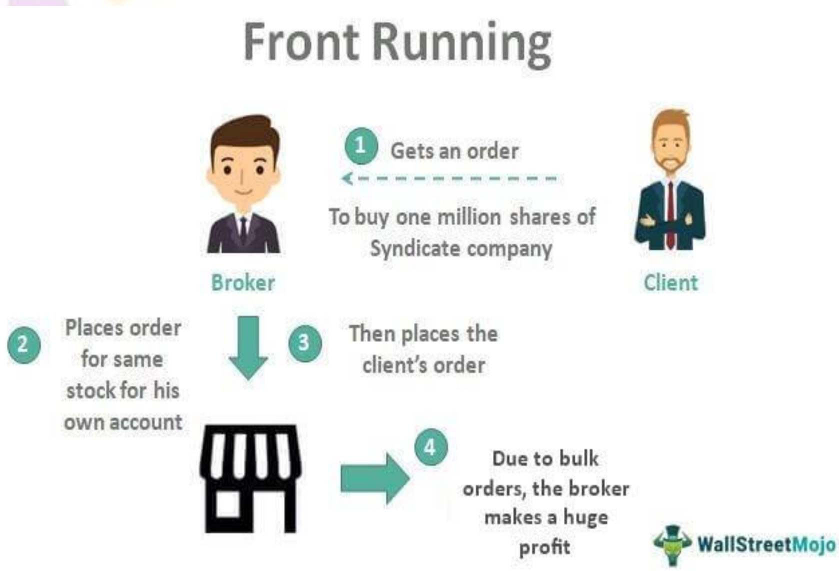
Axis Asset Management Company, which manages assets worth Rs 259,818 crore, suspended two fund managers for various irregularities, including front-running the AMC’s transactions on their personal accounts.

Under the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) or SEBI (PFUTP) Regulations, 2003, any individual who indulges in fraudulent and unfair trade practices is liable to pay a penalty that may extend to Rs 25 crore, or three times the profits made out of such practices, whichever is higher.

What is Front Running?

This illegal practice involves purchasing a stock based on advance non-public information regarding an expected large transaction that will affect the price of the share. When mutual funds make a big order, some fund managers buy the same shares in their personal accounts before executing the MFs’ order. When MFs purchase in huge quantities, the price of the share is expected to go up.

As per Sebi, this is a form of market manipulation and insider trading because a person who commits a front running activity expects security’s price movements based on the non-public information.



Front Running v/s Insider Trading

Front-running is commonly confused with insider trading, but they are distinct. Insider trading refers to a company insider who trades on advanced knowledge of corporate activities–for example, using their insider knowledge to buy or sell shares ahead of a major announcement.

Index Front Running - Legal

Index front running is not illegal and is utilized as a trading strategy. Index funds, which shadow the market indices, are becoming extremely significant in financial markets. Whenever a new stock is added to a market index (e.g., Sensex), the announcement is made before the stock is actually added.
For example, BSE announces that Hi-Tech Inc. will be added to the index in the next day. The next day, high-frequency traders may quickly purchase the company's shares before the index funds are able to buy the company's stock. The index funds will push the stock price up because of the large volume of their orders. Therefore, the high-frequency traders profit from the front running the index funds.