Revamping of SEBI Regulations:

* A move towards ensuring lucidity in the Regime
NEW INSIDER TRADING REGULATIONS: AIMED TO CRACK WHIPS ON WILFUL DEFAULTERS
What is Insider Trading?

Insider Trading is trading/dealing of a company’s stock by an insider/connected person on the basis of Unpublished Price Sensitive Information.

- It is breach of a fiduciary duty or other relationship of trust, and confidence.

- It is a crime if made to get wrongful gain or avoid losses.
Insider Trading is one of the most prevailing form of Securities Market Offence worldwide. The genesis Insider Trading is **HUMAN GREED**!

It is really difficult for persons with privileged information which could help him to gain substantial profit or allow avoidance of loss to control the temptation of using these privileged information.

But **possession of privileged information put the person in a fiduciary position** and misusing this position is a Breach of Trust and Fraudulent act.

When a company gets listed - its **promoters, directors and other key employees** as well as **other persons who have more information than general investors** become the trustee of Investors’ interest and are in fiduciary duty to not to use them for their personal benefit.

**Thus, Insider Trading is a Crime!**
**INSIDER TRADING** is the **misuse of privileged position** & **breach of trust** and hence can **disturb whole structure of Securities Market**. It can also be a **big menace for small investors** as they can loose their hard earned money in the hands of corporate insiders, hence its **effective prevention is very significant**.

- The importance of policing insider trading has assumed **international significance** as regulators attempt to boost the confidence of investors
- Prevention of Insider trading is necessary to create a Level Playing Field for Investors in Capital Market
- Effective measures to prevent Insider Trading would **create trust & confidence among the Investor Communities** and help to develop securities market
- All international capital markets have laws on curbing Insider Trading and **is considered as a heinous crime**.
Insider trading has many governance implications, affecting:

- The organization of companies;
- The duties of directors of managing boards and supervisory boards and other corporate insiders;
- The permitted flow of information within companies;
- The disclosure duties imposed to companies.

The main problem in insider trading is conflict of interests and the misuse of power. Utilisation of the power over privileged information.

Therefore, there is a strong connection between corporate governance and insider trading.
Earlier, companies were required to disclose or abstain (to misuse information) – rather focusing on the prohibitive side of insider trading.

Now the Directive indicates companies should abstain and disclose.
Insider Trading: Legal Overview
Applicable Statutes in India

Securities & Exchange Board of India Act, 1992  
04.04.1992

SEBI (Insider Trading) Regulations, 1992#  
19.11.1992

SEBI (Prohibition of Insider Trading) Regulations, 2015  
15.05.2015

Companies Act, 2013  
01.04.2013

#Valid till 14.05.2015
OVERVIEW

With the objective of bringing the basic framework governing the regime of Insider Trading practices in line with the dynamic global scenario and to tighten the gaps of existing norms, SEBI has notified **SEBI (Prohibition of Insider Trading) Regulations, 2015**, on **15th January, 2015**. These Regulations became effective from **15th May, 2015**.
INSIDER TRADING – Sec 195 of Companies Act, 2013

Any act

Subscribing, buying, selling, dealing

OR

Agreeing to subscribe, buy, sell or deal

In any securities by any

Director

OR

KMP

OR

Any other officer of the company

Either as principal or agent, if such

Director

OR

KMP

OR

Any other officer of the company

Is reasonably expected to have access to any non-public price sensitive information in respect of securities of Company

OR

An act of counseling about procuring or communicating directly or indirectly any non-public price sensitive information in respect of securities of Company
Definition of Director/KMP/Officer

- Not defined in PIT Regulations;
- Definitions to be taken from CA 13;
- “Director” means a person appointed to the Board of the Company;
- “KMP” means CEO/MD/Manager/CS/WTD/CFO/other officers, as prescribed;
“Officer (Section 2(59))”

Includes

- Director
- Manager
- KMP
- Any person

As per whose directions/instructions, the Board/Directors are accustomed to act
The guiding principle.....

• An officer is a person who has the power of directing others to do a particular task, whereas an employee generally follows/obeys
Who is an Insider?

The Regulations also intend to bring in its ambit persons who may seemingly not occupy any position in a company but are in regular touch with the company & its officers & have access to its internal nitty gritties.
Following shall be Connected/ Deemed to be connected with the Company:

- any person who is or has been associated with the company, in any manner, during the six months prior to the concerned act;
- an immediate relative of the connected person;
- a holding / associate/ subsidiary company;
- an official of stock exchange or of clearing corporation;
- a banker of the company;
- A concern, firm, trust, HUF, company or AOP wherein a director of a company/immediate relative/banker of company, has more that 10% of the holding or interest;
- **Legal Consultants and Auditors**, and such other persons who are directly or indirectly, associated with the Company.
Conflicting view......

• Whether a person falls within the ambit of a “Connected Person” or not will always be a mixed question of facts and law............needed to be answered on the facts of each case
What about the status of other persons associated with the Company??

- RTA
- Other Connected Persons
- Freelancers
- ??
What would tantamount to Trading?

Trading means and includes:

✓ Subscribing;
✓ Buying;
✓ Selling;
✓ Dealing;
✓ Agreeing to buy, sell, subscribe, deal in any securities;
SEBI’s Specific Exemption from the ambit of Trading

Vide Guidance Note dated August 24, 2015

Exempted

Exercise Of ESOPs

Only “Exercise” is not considered as Trading, Sale of shares issued pursuant to ESOP Scheme would fall under the ambit of Trading.
Any information, relating to a company or its securities, that is not generally available, and is likely to materially affect the price of the securities is a UPSI.

It includes:-
✓ Financial results;
✓ Dividends;
✓ Change in capital structure;
✓ Mergers, de-mergers, acquisitions, delisting and such other transactions;
✓ Changes in KMPs;
✓ Material events in accordance with listing agreement;
Who will Monitor?

- The Regulations have casted major responsibility for monitoring & implementing the codes specified in these Regulations upon the **Compliance Officer**;

- Compliance Officer means any **senior officer**, designated so and **reporting to the BOD**, who is financially literate and well-versed with legal & regulatory compliances;

- He shall be **responsible for compliance of policies**, procedures, maintenance of records, monitoring adherence to the rules for the preservation of unpublished price sensitive information, monitoring of trades and the implementation of the codes specified in these regulations under the overall supervision of the board of directors of the listed company;
GUIDING PRINCIPLE & exceptions thereto…

No insider shall communicate, provide or allow access to any UPSI, to any person including other insiders, however, there are certain exceptions to this:

✓ **Except for performance of duties, for legitimate business purposes & on a need to know basis.**

✓ UPSI may be communicated in *connection with an open offer under the takeover regulations*, where the BOD is of the view that the proposed transaction is in the best interest of the company;

✓ If the proposed transaction does not entail an open offer, then the BODs shall disseminate the UPSI at least 2 trading days prior to the proposed transaction;
MOTIVE behind introducing the concept of “NEED TO KNOW” basis

Providing of UPSI only to those who require it for their legitimate purposes or in order to discharge their legitimate duties.

Information provided on a “need to know basis” is often divided among several individuals or departments so that no one can individually possess it in entirety. The main purpose behind this is to protect the integrity of a sensitive or undisclosed piece of information.
Hon’ble SAT in the matter of Rakesh Agarwal v. SEBI observed that Legitimate transactions are generally been undertaken to achieve a corporate purpose or to discharge a fiduciary duty or transactions in the public interest without an intent to make profit or gain unlawfully or without a view to misuse information, or the like.

Thus, the whole function of the Regulation introduced is to regulate, not to stop transactions from taking place.
These Regulations entail a new concept of trading plans which was not there under the erstwhile Regulations on insider trading:

- Insiders have an option to formulate a Trading Plan & present it to compliance officer for approval & public disclosure. Upon approval, the Compliance Officer shall notify the TP to the Stock Exchanges.
- Trading plan shall be for a period of 12 months.
- Such TP shall not entail commencement of trading earlier than 6 months from public disclosure of plan.

This is in line with the safeguards introduced by US for insiders....
Requisites of Trading Plan

- **Effective date for commencement of Trading Plan:** Any TP to be executed only on expiry of six months from the date of public disclosure of the said plan.

  - For instance, if any designated employee submits his TP on May 30 which gets approved and publicly circulated on June 20 then such designated employee can commence trading under the said plan only with effect from December 21.

- **Prohibited Period under Trading Plan:** Trading, as per the Trading plan, shall not take place between 20\(^{th}\) trading days prior to the last day of any financial period for which the results are required to be announced by the Company and 2 trading days after the disclosure of such financial results.

  - For instance, in respect of financial period ending on March 31, 2016, the prohibited period is:
    - 02\(^{nd}\) March, 2016 (being 20\(^{th}\) day prior to the last day the financial period); to
    - 02\(^{nd}\) June, 2016 (being 2 trading days after the disclosure of such financial results), presuming 30\(^{th}\) May, 2016 is the date of disclosure of financial results.
✓ **Tenure of Trading Plan:** Insider can give **one trading plan at a time** and the same should not be for less than 12 months, i.e. there **cannot be any overlapping of trading plans.**

✓ **Disclosures to be made under the Trading Plan:** Any Trading Plan should set out either the value of trades or the number of securities to be traded, along with specific dates and time intervals.
Codes Of Conduct

**CODE OF FAIR DISCLOSURE**

Formulated by: Board of directors of every listed company

Policies shall be framed in accordance with Schedule A & publish on its website

**CODE OF CONDUCT**

Formulated by: Board of directors of every listed companies, market intermediaries, for all the employees and other persons (including professional firms, auditors, consultants etc.) who are essentially in possession of UPSI

Policies shall be framed in accordance with Schedule B
Some important contents of this Code are:

- Uniform & universal dissemination of UPSI to avoid selective disclosure;
- Designation of a senior officer as a chief investor relations officer to deal with dissemination of information & disclosure of UPSI;
- Appropriate & fair response to queries on new reports & requests for verification of market rumors by regulatory authority;
- Ensuring that information shared with analysts & research personnel is not UPSI;

And more.....
Code of Conduct, Schedule B
(Common for Companies & Intermediaries)

- All information shall be handled within the organization on a need-to-know basis;
- The BOD shall, in consultation with the Compliance Officer, specify the designated persons to be covered by such code;
- A notional trading window shall be used as an instrument of monitoring trading by designated persons. Trading window shall be closed designated persons is expected to be in possession of UPSI;
- Compliance officer shall determine timing for re-opening of the trading window, which shall not be than 48 hrs when the information becomes publically available;
- Designated persons shall be subject to pre-clearance by compliance officer;
- Code of conduct shall stipulate such formats as the BOD deems fit for making applications for pre-clearance etc.

And more.....
“Notional Trading Window” means a temporary restriction on the trading by the designated persons and any other person as the Compliance Officer deems fit in consultation with the Board, during the period when the discussions pertaining to policy decisions/ any proposed corporate action are being made within the Company but formal decision for the same is yet to be taken.

*To ensure that no fraudulent dealing in securities takes place, the Notional Trading Window may be created from time to time.*
Contra Trade....

A term used to denote a reciprocal trade transaction in respect of a transaction previously executed.

For instance: If Mr. A has purchased 5000 Equity Shares on X date and to earn benefit and nullify the transacted have entered into opposite transaction i.e. sale transaction on X+10 date, then it would be considered as Contra Transaction.

As per the Schedule to the Insider Trading Regulations, restrictions for a minimum time period of 6 months is required to be imposed on the Designated Employees for entering into a contra transaction.
FACTUAL SITUATIONS RELATED TO CONTRA TRADE
Whether the restriction on execution of contra trade in securities is applicable in case of buy back offers, open offers, rights issues FPOs etc by listed companies?

Buy back offers, open offers, rights issues, FPOs, bonus, etc. of a listed company are available to designated persons also, and restriction of ‘contra-trade’ shall not apply in respect of such matters.
Whether restriction on execution of contra trade is applicable only to designated persons of a listed company or whether it would also apply to the designated employees of market intermediaries and other persons who are required to handle UPSI in the course of business operations?

The code prescribed by the Regulations is same for listed companies, market intermediaries and other persons who are required to handle UPSI in the course of business operations. Therefore, restrictions with regard to contra trade forming part of code of conduct shall apply to all according to the Regulations.
Any transaction executed on the basis of UPSI by any Insider for personal gain will be treated as an offence and the Company shall not be held responsible. Thus, THE ONUS OF PROVING THE INNOCENCE LIES ON THE INSIDER

This is in line with the judgment passed in one of the Insider Trading Case being decided in US wherein Driver was guilty of using Price Sensitive Information.
Defences available to an Insider

✓ Contract confidentiality & Non-disclosure agreements has been executed;

✓ The transaction is an off-market *inter-se* transfer between promoters;

**In case of non-individual insiders:**

✓ Individuals who were in possession of such UPSI were different from the individuals taking decisions;

✓ Appropriate & adequate arrangements were in place to ensure that Regulations have not been violated;

✓ Trades were pursuant to a trading plan;
• In the past, personal exigencies, like child’s wedding/ medical treatment have been held as a valid ground for trading in the shares of the company, thus reducing the gravity.

• Now, under the PIT 15 Regulations, that would be possible s.t. pre clearance from the Compliance Officer.
DISCLOSURES

INITIAL DISCLOSURE

CONTINUAL DISCLOSURE

DISCLOSURE BY CONNECTED PERSONS
<table>
<thead>
<tr>
<th>TYPE OF DISCLOSURE</th>
<th>WHAT</th>
<th>BY</th>
<th>TO</th>
<th>DURATION</th>
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</thead>
<tbody>
<tr>
<td>INITIAL DISCLOSURES</td>
<td>Holding in the Company</td>
<td>Promoter, KMP or Director of a listed company</td>
<td>Company</td>
<td>Within 30 days of these Regulation taking effect (i.e. by 13\textsuperscript{th} June 2015)</td>
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<td></td>
<td>Holding on the date of appointment</td>
<td>Promoter, KMP or Director</td>
<td>Company</td>
<td>Within 7 days of such appointment</td>
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<tr>
<td>CONTINUAL DISCLOSURES</td>
<td>Value of securities traded, in aggregate, in a calendar quarter, exceeds traded value of Rs. 10 Lac or any other value as may be prescribed</td>
<td>Promoter or Director or Employee</td>
<td>Company</td>
<td>Within two trading days of such transaction</td>
</tr>
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<td></td>
<td>Company</td>
<td>Stock Exchange</td>
<td></td>
<td>Within two trading days of receipt of disclosure</td>
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<tr>
<td>TYPE OF DISCLOSURE</td>
<td>WHAT</td>
<td>BY</td>
<td>TO</td>
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<tr>
<td>DISCLOSURE BY OTHER CONNECTED PERSON</td>
<td>As required by the company</td>
<td>Connected Person</td>
<td>Company</td>
<td>As specified by the Company</td>
</tr>
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</table>
FACTUAL SITUATIONS RELATED TO CONTINUAL DISCLOSURE
The Employee, Director or Promoter dealing in the securities of the Company, are required to disclose the transaction where the value of securities traded, in aggregate, in a calendar quarter, exceeds traded value of Rs. 10 Lacs.

If any Employee, Director or Promoter deals in every calendar year upto the value of Rs. 9.99 Lacs then they are not required to make any disclosure.

<table>
<thead>
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<th>Quarter</th>
<th>Value of Transaction (in Rs.)</th>
<th>Disclosure required or Not</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarter 1</td>
<td>Rs. 9.99 Lacs</td>
<td>??</td>
</tr>
<tr>
<td>Quarter 2</td>
<td>Rs. 9.99 Lacs</td>
<td>??</td>
</tr>
<tr>
<td>Quarter 3</td>
<td>Rs. 9.99 Lacs</td>
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</tr>
<tr>
<td>Quarter 4</td>
<td>Rs. 9.99 Lacs</td>
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PENALTIES

Any contravention of these Regulations shall be dealt with by SEBI in accordance with the SEBI Act, 1992.

MONETARY PENALTY:
Section 15G of the Act imposes penalty of at least Rs10 Lacs, which may extend to Rs. 25 Crore or three times of profits made out of insider trading, whichever is higher.

IMPRISONMENT:
Section 24 of SEBI Act even goes to the extent of imprisonment upto 10 years or fine upto Rs. 25 Crore, or both, for any offences pertaining to contravention of the provisions of the Act.
FACTUAL SITUATIONS
Situation I: Giving instructions for selling of shares of the company by Mr. A on coming across the fact of the nervous breakdown of Mr. X, Key Personnel of the company who is considered as a chief in the success of that Company. Will this tantamount to violation of Insider Trading Regulations?

The two inferences can be drawn on the basis of above situational analysis:

**Inference 1:**

Mr. A and Mr. X both are colleagues. The nervous breakdown took place in the meeting of the Company which was attended by Mr. A. Since the event occurred in a private meeting, giving instructions to the broker for selling of shares will be considered as a violation of Insider Trading Regulations.

**Inference 2:**

The nervous breakdown took place in the restaurant where both Mr. X and Mr. A came for dinner with their respective families.

Since the event occurred in the public place, therefore, that information would be considered as “generally available information”. Thus, giving instructions to the broker for selling of shares will not be considered as a violation of Insider Trading Regulations.
Situation II: Trading in shares of the company on the basis of future revenue projections of the company will tantamount to violation of Insider Trading Regulations if the same has not been made public by the Company

The two inferences can be drawn on the basis of above situational analysis:

Inference I:

If Mr. A was passing by the warehouse of the company where he observed the movement of goods from such warehouse and accordingly formed an opinion about the estimated revenue of the Company. Based upon the opinion formed, he traded in the shares of the company.

In the given situation, the same information can be accessed by anyone passing by the warehouse of the company. This information can be considered as the generally available information. Therefore, dealing in the shares of the company based on such information will not be considered as a violation of Insider Trading Regulations.
**Case II:** Trading in shares of the company on the basis of future revenue projections of the company will tantamount to violation of Insider Trading Regulations if the same has not been made public by the Company.

**Inference 2:**

If Mr. A has procured information about projected revenues from an insider who is passing on such information in breach of his duties to keep such information confidential, then trading on the basis of such information would be considered as trading in possession of unpublished price sensitive information and is considered as a violation under Insider Trading Regulations.
Case Study related to Issuance of shares under ESOP

If any designated person purchases some shares (say on October 01, 2015), acquires shares later under an ESOP (say on October 15, 2015), the acquisition under ESOP shall not be a contra trade. But if he chooses to sell the shares acquired under ESOP then whether such transaction would fall under the ambit of contra trade.

The sale of shares acquired under ESOP shall not be covered under the ambit of contra trade. However, he will not able to sell the shares acquired on October 01, 2015 for a period of six months from October 01, 2015.
Case Study related to Pledge of shares

Whether creation of pledge or invocation of pledge is allowed when trading window is closed?

Yes, however, the onus is on pledgor or pledgee to prove their innocence.
Case Study related to Pledge of shares

What should be the value of the pledge / revoke transaction for the purpose of disclosure? Is it the market value on date of the pledge / revoke transaction or is it the value at which the transaction has been carried out between the pledgor and pledgee? For instance, if the pledgor has availed a loan of Rs 10 Lacs against which he has pledged shares worth Rs 15 Lacs, would the transaction value be Rs 10 Lacs or Rs 15 Lacs.

For the purpose of calculation of threshold for disclosures relating to pledge under Chapter III of the Regulations, the market value on the date of pledge/revoke transaction should be considered. In the above illustration, the value of transaction would be considered as fifteen lakh rupees.
If a spouse is financially independent and does not consult an insider while taking trading decisions, is that spouse exempted from the definition of ‘immediate relative’?

A spouse is presumed to be an ‘immediate relative’, unless rebutted so.
Case Studies.....

• Rajat Gupta in 2012 was imprisoned for 2 yrs. He was on the Board of many blue chip co., whose UPSI, he used to share with friends, thus making huge profits. He was held guilty.
To sum up….  

It is possible to conclude that the modern approach towards Insider Trading is:

• **Broader** - considering e.g. types of securities concerned;
• **More ambitious** - given the range of professionals involved (not only insiders);
• **More connected with governance** issues;
• **Eminently preventive** and more focused on clear and effective guidance regarding timely disclosure of price-sensitive information.
Corporate Professionals Capital Pvt. Ltd
SEBI Registered Category I Merchant Banker
D-28, South Extension -I,
New Delhi-110 049
Ph: +91.11.40622200; FAX: +91.11.40622201
Contact: Anjali Aggarwal,
Partner & Head, Capital Markets & Stock Ex Services
Mobile: + 91 9971673336 | Tel: +91.11.40622230| Email: anjali@indiacp.com

Our Services: Public Issue Management | Private Placements | Corporate Debt Funding | Mergers & Acquisitions | Business Valuations | ESOP/ESPS | Transaction Advisory | Cross Border Restructuring