



Decoding the amendments to Prohibition of Insider Trading Regulations: How will they impact transactions?

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The issuance of the Securities and Exchange Board of India (Prohibition of Insider Trading) Amendment Regulations, 2018 (PIT Regulations) in December 2018 by the market regulator brought with it several amendments to the regulations including additional compliance requirements for listed companies and persons with access to unpublished price sensitive information (UPSI).

One such condition that has been introduced is the requirement of the trading window being shut from the end of every quarter till 48 hours after the declaration of the financial results. It is important to note that as per the PIT Regulations, 'designated persons' and immediate relatives of designated persons are restricted from 'trading' in securities when the trading window is closed (restricted period). The PIT Regulations mandate that a listed company maintain a code of conduct which prescribes the restriction on the ability of designated persons to trade during the restricted period.

The trading window is a notional concept that exists to monitor trading by such designated persons. The board of directors of a listed company, in consultation with the compliance officer, are required to specify and identify the designated persons for a company and this would generally include employees who may have access to UPSI and promoters of listed companies. The definition of 'trading' under the PIT Regulations itself is wide and includes subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell, deal in any securities.

Considering that the definition of 'trading' itself is quite broad, the inclusion of the requirement of closing of the trading window during the restricted period, is restrictive as far as designated persons of each company are concerned. For instance, taking the restricted period into account for the year, it would imply that the trading window may be shut for a prolonged period - possibly, almost half the year. Surely, it must not be the intention of the regulator to restrict legitimate transactions by designated persons to such an extent.

The question that arises then is whether the inclusion of such a provision would mean that this trading restriction imposed on designated persons is applicable even if the underlying transaction triggers an open offer, where public shareholders are amply protected. While a preliminary reading of the PIT Regulations could give the impression that this is the case, a closer examination and deeper analysis of the PIT Regulations offers a different perspective.

Analysis

The foremost purpose of the PIT Regulations is to ensure that the public shareholders are not at a disadvantage in comparison to persons within the company who have access to UPSI. A purposive reading of the PIT Regulations will reveal that the restriction on trading during the restricted period should not be read in isolation but must be reviewed from the standpoint of whether public shareholders of a listed company have not been treated at par or have not received the same benefit as an incoming investor or an insider who has access to UPSI. For instance, where a transaction triggers an open offer, the acquirer is provided access to UPSI but the public shareholders will not suffer a loss, as it provides them an equal opportunity to exit without any mis-match on pricing expectations. Another accepted principle of the PIT Regulations is that the transaction itself is between an acquirer and seller who are both 'insiders' having access to the same UPSI and to that extent no one party is at a loss.

While listed companies and persons with access to UPSI have an inherent responsibility towards public shareholders to not misuse the information that they are privy to, it is important that the PIT Regulations are not interpreted in a manner that has a negative impact on legitimate transactions by designated persons.

One must also consider that Regulation 2(1) of the PIT Regulations provides that the definitions used in the PIT Regulations would have the meaning assigned to them unless the 'context otherwise requires'. Therefore, the definition of 'trading' need not be viewed strictly in the manner provided for in the PIT Regulations but may be evaluated on a case-to-case basis. Assuming a legitimate transaction is being undertaken, designated persons may be justified in 'trading in securities' during the restricted period. This argument may be further substantiated where an open offer is triggered, and the public shareholders are not disadvantaged in any manner. Further, as such, the code of conduct that a listed company is required to maintain, should be treated as an administrative tool to monitor transactions and must not be read in

isolation. Therefore, it is important that the intent of the legislation be considered, and the relevant regulations be analysed in a holistic manner.

Exceptions

Considering this, Sebi received several representations requesting that this restriction be eased up in a manner that does not impact genuine transactions. In this regard, during a recent Sebi board meeting, these issues were discussed and considered. It appears that Sebi, has agreed to review its position and has clarified that it has considered certain exceptions to trading during the restricted period. We understand that these exceptions would include transactions such as (a) off-market inter-se transfer between insiders, (b) transaction through block deal window mechanism between insiders, (c) transaction due to statutory or regulatory obligations, (d) exercising of stock options, (e) pledging of shares for bona fide transaction such as raising of funds, (f) transactions for acquiring shares under further public issue, right issue and preferential issue, (g) exercising conversion of warrants debentures, (h) tendering shares under buy-back, open offer and delisting under relevant regulations (proposed exclusions). However, these exclusions would be subject to certain conditions.

In this context, while the discussions on the PIT Regulations during the Sebi board meeting are certainly a step in the right direction, the true impact of the proposed exclusions can be evaluated only once the PIT Regulations are formally amended. We certainly hope that the conditions imposed by Sebi do not dilute the inclusion of the proposed exclusions or pose a hurdle for genuine transactions, in any way.

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