Insider Trading and 'Price Sensitive Information' in India

Parveen Kumar
National Head
Assurance/Director
ASA & Associates LLP

Insider Trading in markets gives rise to various issues that are ethical, legal and economic. It creates an unequal plane that doesn't provide uniform opportunity to the market participants to exploit information in order to execute trades in various types of securities. This places those who are not in possession of such inside information at a disadvantage that jeopardizes their faith the market system. It further affects their will to participate that hampers the flow of financial markets which is obviously not healthy for the economy in the long run. This Article tries to briefly analyse the law relating to Insider Trading in India keeping in view the legal framework relating to 'price sensitive information', 'insider' and defences available to communicators of such information. It also outlines the change in legal framework brought in by the 2015 SEBI regulations and 'due diligence carve-out' which is an exception added in light of the extensive merger and acquisition deals taking place in the country today.

What Is Insider Trading?

Insider Trading is a term used for one of the malpractices wherein the 'Insider' i.e. a person having access to information which rest of the public doesn't, uses it to his undue advantage as it is crucial to make investment decisions. This is considered to be unfair because of the imbalance in egalitarian plane created by the virtue of relative positions of different investors vis-a-vis the company. In other words, when the key managerial executives or directors or employees use their access to strategic information which is capable of giving them an upper hand in comparison to other investors, for trading in securities, they are said to practise what is called 'insider trading'[1]. In order to promote fair trading in the market for interest of a common investor, this practice is highly discouraged by the Securities and Exchange Board of India so much so that it is illegal. However, at the same time it is important to note that if the said information has been made public such that all prospective investors have equal access to it, it is not illegal as the accused is no longer an 'insider' with regard to that particular information.

The objective of penalizing provisions in relation to insider trading can be traced back to the fiduciary duty of trust and confidence posed in the employees and others working with a company by virtue of their possession in material, non-public and 'sensitive' information about a security of the company[2]. If they breach this duty, it is bound to shake investor confidence in the fairness and integrity of investor markets.

Legal Framework

The legal framework for insider trading has recently been overhauled as Securities and Exchange Board of India Act, 1992 read with SEBI (Prohibition of Insider Trading) Regulations, 1992 has now been replaced with SEBI (Prohibition of Insider Trading) Regulations, 2015[3] which are wider and more extensive in scope. These came into effect on May 15, 2015. In respect of a listed company or the company, these regulations prohibit provision as well as receipt of

1. http://economictimes.indiatimes.com/definition/insider-trading
2. https://www.sec.gov/fast-answers/answersinsiderhtm.html
3. http://www.sebi.gov.in/sebi_data/attachdocs/1421319519608.pdf

'Unpublished Price Sensitive Information' through the following prohibitions -

- An insider from communicating unpublished price sensitive information;
- Any person from procuring unpublished price sensitive information from an insider;
- An insider from trading in securities when in possession of unpublished price sensitive information.

Regulation 3 expressly prohibits communication and procurement of price sensitive information.

SEBI (Prohibition of Insider Trading) Regulations, 2015also deals with the insider trading. The conflict are many, a major one is especially for defence. These new regulations are lenient and provides quite a few defence (communication of Unpublished Price Sensitive Information related provisions) while section 195 is stricter, which provides only window of defence to the person (communication required under ordinary course of business), which is primarily inspired from the old SEBI (Prohibition of Insider Trading) Regulations, 1992.Post Companies Act 2013, SEBI faces question of which regulation to apply –The act or its own published regulations. An interesting twist in the old regime and the new.

Who is an Insider?

Regulation 2(g) of the 2015 Regulations define 'insider' as a connected person, or anyone in possession of unpublished price sensitive information. A note to this Regulation as published in the Official Gazette further clarifies that anyone in possession of such information must be considered an 'insider' irrespective of how he came in possession of it. The explanatory note further states that the onus of proving someone an 'insider' shall be on the one levelling the charge against him.

Disclosure requirements are a significant part of the insider trading regime as every key managerial person or director is obligate to disclose to his company his holding of securities of the company as on date of appointment or as of the date of notification of the new SEBI Regulations which is May 15, 2015. The employee, director or promoter will have to make continual disclosures in case the traded value of security exceeds the monetary threshold of INR 10,00,000.

Regulation 2(d) defines a 'connected person' as the one who is directly or indirectly associated with the company for 6 months or more prior to the concerned act; or by being in a fiduciary, contractual or employment relationship; or by holding a position by virtue of a business or professional relationship with the company whether temporary or permanent that enables him to have access or is reasonably expected to have excess to unpublished price sensitive information[4]. Some persons like immediate relatives, holding and subsidiary companies etc. are deemed to be connected.

What is Unpublished Price Sensitive Information?

Unpublished price Sensitive Information means any information regarding a company or its securities which is not 'generally available', i.e. not accessible to the public on a non-discriminatory basis, which if made available, is capable of materially affecting the price of the securities.

4. http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Mergers___Acquisitions_in_India.pdf

A non-exhaustive list of such information has been given in Regulation 2(n) of the 2015 regulations which includes financial results, dealings, disposals, changes in key managerial personnel, disposal/expansion of business and so on. Material events in accordance with the listing agreement like change in general character of business, commencement or disruption of operations due to various reasons like natural calamity or strikes, regulatory action, revision in ratings and so on.

The non-exhaustive list of unpublished price sensitive information has been produced below-

- financial results;
- dividends;
- change in capital structure;
- mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions;
- changes in key managerial personnel; and
- material events in accordance with the listing agreement.

Defences/Exceptions

There are various exceptions to the communication and procurement of unpublished price sensitive information if such communication or procurement is in furtherance of legitimate purposes, performance of duties or legal obligation. The defences available to persons are explained through the table given below.

Another exception that is carved out for such transactions is regarding due diligence. The due diligence carve out is expected to recognise the practical aspects of commercial transactions which often require some sort of disclosure of non-public information as it is both legitimate and necessary for analyzing the merits of a transaction. Regulation 3(3) therefore allows the firms to communicate unpublished price sensitive information subject to the following conditions-

- For transactions that entail the obligation to make an open offer letter under SEBI Substantial Acquisition of shares and Takeovers) Regulations, 2011 also known as the Takeover Code laid down by SEBI, only when the Board of directors is convinced about the transaction being in the best interest of the company by the virtue of being an informed opinion;
- For transactions that do not entail the obligation to make an open letter under the takeover code by SEBI:

Table 1: Defences for the offence of insider trading

Section 195 Companies Act, 2013	2015 SEBI Regulations	
	General	Specific for non-individual insiders
• Communication required under the ordinary course of business or profession.	• If they were in possession of the same unpublished price sensitive information without being in breach of Regulation 3.	• Individuals who executed the trade were different from individuals
	• Both counterparties made a conscious and informed trade decision	• Possession of UPSI and were not in possession of such UPSI
		• Chinese wall arrangements were in place and there was no leakage of information and the Regulations were not violated
		• Trades were made pursuant a trading plan.

- Board of directors is convinced about the transaction being in the best interest of the company by the virtue of being an informed opinion; and
- The information that constitutes unpublished price sensitive information and is proposed to be communicated, is made available at least two trading days prior to the proposed transaction being affected.

These provisions ensure the symmetry of information in the market as well as the availability of all information in the letter of offer under the Takeover Code to enable the shareholders to make an informed divestment or retention decisions.

Disclosure Requirements

Disclosure requirements are a significant part of the insider trading regime as every key managerial person or director is obligate to disclose to his company his holding of securities of the company as on date of appointment or as of the date of notification of the new SEBI Regulations which is May 15, 2015. The employee, director or promoter will have to make continual disclosures in case the traded value of security exceeds the monetary threshold of INR 10,00,000.

Although the Regulations do not contain any penalizing provision for violation of the prohibitions contained in Regulation 3, Regulation 10 empowers SEBI to deal with violations in accordance with Securities and Exchange Board of India Act, 19925. Section 15G of the said Act prescribes a penalty of Rs. 10 lakh extending upto 25 crores or three times the profit made from an insider trading activity, whichever is higher.

Penalty

Although the Regulations do not contain any penalizing provision for violation of the prohibitions contained in Regulation 3, Regulation 10 empowers SEBI to deal with violations in accordance with Securities and Exchange Board of India Act, 1992[5]. Section 15G of the said Act prescribes a penalty of Rs. 10 lakh extending upto 25 crores or three times the profit made from an insider trading activity, whichever is higher.

6. https://www.sec.gov/fast-answers/answersinsiderhtm.html