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## **Analysis of SEBI's Interpretive Letters on Insider Trading Regulations, 2015**

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With an objective to deter the practice of insider trading in the securities of listed companies, SEBI had originally framed SEBI (Prohibition of Insider Trading) Regulations, 1992. After several amendments to the Regulations and also judicial paradigm through various case laws had also evolved to prohibit insider trading. SEBI, on the auspicious occasion of Makar Sankrant & Pongal (Thursday, January 15, 2015), notified Prohibition of Insider Trading ('PIT') Regulations, 2015. The objective to substitute the Regulations was to strengthen the legal and enforcement framework, toughen the insider trading rules, align Indian regime with International practices. SEBI has also introduced few definitions, expanded the scope of existing definitions and at the same time, it has completely overhauled initial and continual disclosures by directors / KMP / employees to the company. After the introduction of SEBI (PIT) Regulations, 2015, SEBI issued various Circulars and Notification for clarifying the provisions relating to its compliance and implementation. Many listed companies approached SEBI and sought for Interpretive Letters. Under the Informal Guidance, Scheme, 2003 ('Scheme'), SEBI-registered intermediary, listed company, Mutual Fund Trustee and acquirer (or proposed acquirer) under Takeover Code can seek SEBI informal guidance in following form:

- (i) **No-action letters** : In which SEBI's Department indicates that Department would or would not recommend any action under any Act, Rules, Regulations, Guidelines, Circulars or other legal provisions administered by SEBI,
- (ii) **Interpretive letters** : In which SEBI's Department provides an interpretation of a specific provision of any Act, Rules, Regulations, Guidelines, Circulars or other legal provision being administered by SEBI in the context of proposed transaction in securities or specific factual situation.

This article is summary and analysis of SEBI's Interpretive Letters on Insider Trading Regulation, 2015.

### **SEBI clarifies on disclosures under Insider Trading Regulations for allotment of shares by merger/demerger/gift**

Kotak Mahindra Bank sought for an Interpretative Letter from SEBI under SEBI (Informal Guidance) Scheme, 2003 and raised certain issues relating to disclosures under SEBI's Insider Trading Regulations. The Bank asked for clarification on the disclosures for certain unique

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transactions like bonus shares, shares received pursuant to the scheme of amalgamation/demerger, gift or off market transaction like transfer of shares to a family trust account, where the traded value is nil and the same cannot be considered for computing the prescribed threshold limit (Rs. 10 lacs).

*Relevant Regulations* : Pursuant to Reg. 7(2)(a) of SEBI's Insider Trading Regulations, every promoter, employee and director of the company to disclose to the company the number of such securities acquired or disposed of within 2 trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to traded value in excess of Rs. 10 lacs or such other value as may be specified. Under Reg. 7(2)(b) of SEBI's Insider Trading Regulations, the company has to notify the particulars of such trading to the stock exchanges on which the securities are listed within 2 trading days of receipt of the disclosure or from becoming aware of such information. In the Explanation to Reg. 7(2)(b), SEBI has clarified that disclosure of incremental transactions after any disclosure shall be made when transactions effected after the prior disclosure crosses the prescribed threshold.

*Crux of SEBI's Interpretive Letter & Analysis* : In the Interpretive Letter, SEBI<sup>1</sup> has clarified that where the person getting allotment of shares has no role in the transaction in question and relevant information or disclosure of such transaction is already in the public domain (e.g. Bonus shares or shares received pursuant to Scheme of amalgamation/demerger), a separate disclosure may not be necessary. However, for all other instances (e.g. Off-market transaction or gifts, etc.), disclosure would be required under the Regulations. W.r.t. the query on valuation, SEBI stated that the term 'value of securities traded' is interpreted as the prevailing market value of the securities on the day the shares are acquired or disposed off. SEBI stated that the same may be used for the purpose of calculation of threshold value beyond which disclosure is required and must also be disclosed in the referred form. In my view, SEBI has rightly interpreted and provided clarity on the trigger point for disclosures on certain unique types of transactions.

### **SEBI clarifies on requirement of promoter's pre-clearance under Insider Trading Regulations, elucidates role of Compliance Officer**

Kirloskar Chillers Pvt. Ltd. ('KCPL') is a part of the promoter group of Kirloskar Brothers Limited ('KBL'). The 'Promoter and Promoter Group' of KBL collectively hold 65.44% of the total paid-up capital of KBL (as on Sep. 30, 2016). KCPL currently does not hold any equity shares in KBL. Being public listed company, KBL has "Code of practice and procedures for fair disclosure of UPSI and Code of Conduct" ('COC') to regulate monitor and report trading by insiders of KBL in accordance with Insider Trading Regulation. In letter addressed to SEBI it was disclosed that, KCPL intended to acquire 50,000 equity shares, constituting 0.06% of the paid-up capital of KBL ("Proposed Acquisition"). KCPL, being qualified as Promoter group entity of KBL, was required to adhere to requirements contained in the COC i.e. obtaining pre-clearance from KBL's Compliance Officer for the proposed acquisition. At the time of obtaining pre-clearance, KCPL submitted the requisite declaration/undertaking that it does not possess any UPSI. The Compliance Officer rejected the application without any valid grounds. The

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1 SEBI Letter No. ISD/OW/9966/2017 dated April 28, 2017.

Compliance Officer attempted to justify the said rejection by stating certain reasons. Based on this background, KPCL sought guidance from SEBI on legal provisions relating to requirement of pre-clearance from the Compliance Officer and the grounds on which pre-clearance can be rejected by the Compliance Officer.

*Crux of SEBI's Interpretive Letter & Analysis* : In its introductory remarks of the Interpretive Letter, SEBI<sup>2</sup> pointed out that Insider Trading Regulations are prohibitive Regulations and the applicability of its provisions, is w.r.t. Insiders and such concerned securities to which UPSI might pertain. This is to ensure that there is no undue advantage accrued to such class of investors, on account of their access to UPSI at the expense of general market participants. SEBI clarified that the pre-clearance is required to be obtained only by "Designated persons" if the value of the proposed trades is above such thresholds as stipulated by the board of directors. Therefore, a promoter, if designated as "Designated Person" by the board of directors in consultation with the Compliance Officer, will be required to obtain pre-clearance for trading. SEBI stated that "Schedule B of PIT Regulations casts certain obligations on the Compliance Officer which has to be complied accordingly. The Compliance Officer may approve or reject a pre-clearance request after necessary assessment as per the PIT Regulations and the Code of Conduct." SEBI referred the provisions of PIT Regulations w.r.t. the powers of Compliance Officer and observed that "*Any question with respect to the act of compliance officer whether or not extraneous to the powers so conferred according to the PIT Regulations and the Code of Conduct, may be referred to the board of directors and the audit committee for examination in accordance with the extant laws and the relevant facts of the case*". SEBI, in its Interpretive Letter, concluded by stating that the basic intent of Insider Trading Regulations is that no undue advantage accrue to certain category of investors on account of their access to UPSI. However, SEBI also stated that "*Any actions of Compliance Officers, Board of Directors or other entities entrusted with ensuring adherence to these Regulations, should be to ensure compliance in letter and spirit to the PIT regulations and not for any ulterior motive.*"

### **SEBI interprets Insider Trading Regulations, observes that investing through discretionary Portfolio Management Scheme amounts to 'insider trading'**

HDFC Bank sought for an Interpretative Letter from SEBI under SEBI (Informal Guidance) Scheme, 2003. The Bank stated that some its employees, who may be in possession of UPSI of the Bank or of other listed companies with whom Bank deals, are consequently restricted from dealing in securities of the Bank or such other listed companies. The employees may choose to invest their funds in securities market through portfolio management schemes. The portfolio managers, under the discretionary portfolio management scheme, deals in the securities with the funds of the investors (investor includes employees of the Bank and his relative), as per its own discretion and the investor has no direct/indirect control/influence over the investment making decisions. HDFC Bank stated that the Portfolio Manager, while exercising his discretion, makes investment/disinvestment in securities, which may includes securities of Bank or securities of a listed company, for which the employee or his relative may be in possession of UPSI by virtue of being employee of the Bank, but the employee of the bank or his relative has no control directly or indirectly, over investments making decisions of the Portfolio Manager.

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2 SEBI Letter No. ISD/2700/2017 dated February 3, 2017.

*Understanding Discretionary Portfolio Management Scheme* : Under such scheme, the day-to-day investment discretion are fully delegated to Portfolio Manager and is not shared with the investor. The Portfolio Manager does not discuss any potential investment/disinvestment decisions with investor before any transaction and the investor. The investor does not make suggestions to Portfolio Manager regarding specific investments/disinvestments and the Portfolio Manager does not advise the investor of trades prior to their execution. The Portfolio Manager does not accept specific orders to buy and sell of any security at the direction of its client. The portfolio is standard portfolio and is not altered specifically for an investor. Investments in securities of companies as a part of discretionary portfolio management scheme is identifiable and the securities in the portfolio are mandatorily held in a separate demat account with power of attorney in favour of the portfolio manager.

*Crux of SEBI's Interpretive Letter & Analysis* : SEBI<sup>3</sup> issued an Interpretive Letter to HDFC Bank Ltd. and opined that investing in securities through discretionary Portfolio Management Scheme amounts to 'insider trading'. SEBI perused the provisions of Insider Trading Regulations and stated that "Dealing in securities, whether it is direct or indirect is not relevant, but that an insider when in possession of UPSI should not deal in securities of the company to which the UPSI pertains. Even while dealing in such securities through a discretionary PMS, the trades of insider shall be assumed to be motivated by knowledge and awareness of USPI". SEBI observed that "Reg. 4(1) read with Sec. 4 of Schedule B of Insider Trading Regulations, infers that the dealing by the Banks or the company with which the Bank deals in securities through discretionary PMS, when the trading window is closed, shall be assumed to be motivated by the knowledge and awareness of UPSI". SEBI has strictly interpreted the provisions of the Insider Trading Regulations and observed that investing through discretionary Portfolio Management Scheme amounts to 'insider trading'. In my view, SEBI ought to have considered 'knowledge of the trade' and 'knowledge of the UPSI' for the purpose of determining applicability of Insider Regulations. This Interpretive Letter may also affect the investments by bank employees in equity market.

### **SEBI interprets 'securities' & applicability of Code of Conduct under Insider Trading Regulations**

Prabhudas Lilladhar Pvt. Ltd. sought for an Interpretative Letter from SEBI under SEBI (Informal Guidance) Scheme, 2003. Few of the issues raised by Prabhudas Lilladhar Pvt. Ltd. are: (i) Whether certain provisions of Insider Trading Regulation are applicable to the directors of an unlisted Market Intermediary or his immediate relative or bankers of an unlisted Market Intermediary, (ii) Whether certain bonds can also be exempted from the definition subject to no UPSI attracted inherently on such bonds, (iii) Whether Senior Professional who does not have access to UPSI can request the Compliance officer for exclusion as "designated person" under the Code of Conduct.

*Crux of SEBI's Interpretive Letter & Analysis* : SEBI<sup>4</sup>, in its introduction to the Interpretive Letter, stated that Insider Trading Regulations by nature are prohibitive Regulations. The applicability of its provisions is w.r.t. Insiders and such concerned securities to which UPSI

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3 SEBI Letter No. ISD/20812/2016 dated July 25, 2016

4 SEBI Letter No. ISD/34644/2016 dated December 23, 2016

might pertain, so that there is no undue advantage accrued to such class of investors. SEBI referred to the provisions relating to ‘deemed to be connected persons’ (i.e. clause (j) Reg. 2 (1)(d)(ii)). SEBI clarified that the “Company” in the phrase “director of company or his immediate relative or banker of the company”, referred to in the clause of Insider Trading Regulations, implies a listed company to which UPSI may pertain. With respect to Prabhudas Lilladhar Pvt. Ltd.’s question on whether certain bonds can also be exempted, SEBI clarified that exclusion provided from the definition of ‘securities’ is with respect to ‘Mutual Funds units’ only. On the applicability of the Code of Conduct, SEBI stated that “Employees and connected persons are designated on the basis of functional role and not only on seniority. Code of conduct applies to all connected persons and not only to designated persons. It may further be stated that designated persons are specified by the Board of Directors in consultation with the Compliance Officer.”

### **Conclusion**

SEBI’s Interpretative Letter can be considered as some sort of clarification on the Insider Trading Regulations. SAT in a recent ruling clarified the legal sanctity of Interpretive Letters. With reference to the Takeover Code read with SEBI’s Interpretive Letter, SAT<sup>5</sup> ruled that “A straight forward reading of Reg. 10 of Takeover Regulations 2011 unambiguously shows that the Appellants were not eligible for exemption. When a straight forward reading of the Regulation/law is available that is the only way it should be read. In the instant matter no other interpretation is actually possible... When the statute is clear, informal guidance should not be relied on. Informal guidance scheme cannot be used to reduce the importance of the statute itself”. SAT observed that the guidance is the view of the concerned department of SEBI and will not be binding on SEBI. SAT observed that the letter issued by SEBI’s Department under this Scheme should not be construed as a conclusive decision or determination of any question of law or fact by SEBI. SAT also stated that such letter cannot be construed as SEBI’s order under Section 15T of SEBI Act, and shall not be appealable.

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5. In the matter of Arbutus Consultancy LLP vs. SEBI, Order dated April 5, 2017.