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[2021] 127 taxmann.com 206 (Article)

[2021] 127 taxmann.com 206 (Article)

Date of Publishing: May 5, 2021

SAT interprets materiality under SEBI (PIT) Regulations, partially upholds SEBI order

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A disclosure-based regulatory regime is founded on timely and adequate disclosure of all events material to a company or to its securities in any manner.In a recent order, SAT has interpreted the provisions of SEBI (Prohibition of Insider Trading) Regulation, 2015 ('SEBI (PIT) Regulations'). SAT's interpretation has a very wide impact on the content, nature and timing of disclosures by listed entities to the stock exchanges. SAT has also interpreted materiality of disclosure under SEBI (PIT) Regulations. This article is an analysis of SAT order and its implications on disclosures under the said Regulations by Compliance Officers to the stock exchanges.

Facts of the case: Ecap Equities Limited ('Ecap'), a wholly owned subsidiary of Edelweiss Financial Services Limited ('Edelweiss') acquired a fintech company – Alternative Investment Market Advisors Private Limited ('AIMIN'). Such acquisition was made by purchasing 100% of AIMIN's equity capital. Consequent to the signing of Share Purchase Agreement, a disclosure to this effect was made to the stock exchanges by Edelweiss on April 5, 2017. Such disclosure was made under Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations'). However, the Term Sheet in respect of the said acquisition was signed between Ecap and AIMIN on January 25, 2017.Though the said disclosure was made on April 5, 2017, the listed entity did not close the trading window at any time. SEBI's Adjudicating Officer held that the Compliance Officer, who is mandated to ensure implementation of the Code of Conduct relating to PIT disclosures and compliances as well, violated the Code of Conduct. Accordingly, SEBI levied a penalty of Rs. 5 lacs on the Compliance Officer.

Issue: Whether an acquisition of a company, directly or indirectly by a listed entity, in itself, irrespective of its materiality, becomes an UPSI under the SEBI (PIT) Regulations thereby making it obligatory on the Compliance Officer to close the trading window?

Analysis of important & relevant provisions: According to Regulation 9 of SEBI PIT Regulations, the board of directors of every listed company and market intermediary shall formulate a code of conduct to regulate, monitor and report trading by its employees and other connected persons towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule B to SEBI (PIT) Regulations, without diluting the provisions of the said Regulations in any manner.One of the provisions of Schedule B is that 'designated persons' may execute trades subject to compliance ofSEBI (PIT) Regulations. A notional trading window shall be used as an instrument of monitoring trading by the designated persons. The trading window shall be closed when the Compliance Officer determines that a designated person or

class of designated persons can reasonably be expected to have possession of unpublished price sensitive information ('UPSI'). Such closure shall be imposed in relation to such securities to which such UPSI relates. Designated persons and their immediate relatives shall not trade in securities when the trading window is closed.

Regulation 2(1)(n) of SEBI (PIT) Regulationsdefines 'UPSI' – "*UPSI means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following: (i) Financial results; (ii) Dividends; (iii) Change in capital structure; (iv) Mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions; (v) Changes in key managerial personnel*". It is important to note here that definition of UPSI was amended, wherein '(vi) Material events in accordance with the listing agreement' was omitted by SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2018.

'Generally available information' means information that is accessible to the public on non-discriminatory basis. Such generally available information creates an exception to UPSI, i.e. if certain information is generally available then it is not an UPSI. UPSI relates to direct or indirect information about the company or securities. Such information relates to few events mentioned above. Such events or occasions are just illustrative examples. Therefore, any unpublished information which is relating to the company or securities and such information has a material effect on the price – then such information is UPSI.Taking into account the definition of UPSI and relevant provisions of Schedule B to SEBI (PIT) Regulations, the trading window shall be closed when the Compliance Officer determines that a designated person or class of designated persons can reasonably be expected to have possession of UPSI. Such closure shall be imposed in relation to such securities to which such UPSI relates. According to the provisions, designated persons and their immediate relatives are prohibited from trading in securities when the trading window is closed. Therefore, it is the discretion of Compliance Officer of listed entity w.r.t. closure of trading window only when the designated persons can reasonably be expected to have possession of UPSI.

Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('SEBI Listing Regulations') relates to 'disclosure of events or information'. According to the said provisions, every listed entity shall make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material. Certain events are specified in Para A of Part A of Schedule III to SEBI Listing Regulations. Such events are deemed to be material events and listed entity shall make disclosure of such events i.e. disclosures without any application of guidelines for materiality.

With reference to the SAT order (as a part of this article), 'acquisition' is one of the events to be disclosed by the listed entity i.e. acquisition(s) (including agreement to acquire), scheme of arrangement (amalgamation/merger/demerger/restructuring), or sale or disposal of any unit(s), division(s) or subsidiary of the listed entity or any other restructuring. 'Acquisition' has been defined as: (i) Acquiring control, whether directly or indirectly; or (ii) Acquiring or agreeing to acquire shares or voting rights in, a company, whether directly or indirectly, such thatlisted entity holds shares or voting rights aggregating to 5% or more of the shares or voting rights in the said company, or there has been a change in holding from the last disclosure and such change exceeds 2% of the total shareholding or voting rights in the said company.

Analysis of SEBI Regulations vis-à-vis SAT's observation: It is important to note that the disclosure w.r.t. acquisition by listed entity's wholly-owned subsidiary company was made under Regulation 30 of the SEBI Listing Regulations read with Para A of Part A of Schedule III. Such disclosure was made by the listed entity not because of the concept of materiality but because such disclosure is required to be made irrespective of materiality.In the present case, such disclosure was made after the transaction was confirmed and the share purchase agreement on signed.

The amendment to SEBI PIT Regulations was introduced based on the recommendation of Committee under Chairmanship ofDr.T. K. Viswanathan. The recommendation is part of the Report ofCommittee on

Fair Market Conduct. The Committee noted that SEBI Listing Regulations requires disclosures of material events or information which may or may not be price sensitive. Accordingly, the Committee opined that all material eventswhich are required to be disclosed under SEBI Listing Regulations may not necessarily be UPSI under SEBI PIT Regulations. It was also observed that the definition of UPSI is inclusive, and therefore it was recommended that the removal of explicit inclusion of 'material events in accordance with the listing agreement' in definition of UPSI.This is a very important recommendation of the Committee, based on which the definition of UPSI was amended. In the present case, the listed entity has complied with disclosure requirements under SEBI Listing Regulations.

SAT observed that while materiality w.r.t.price of securities or to company is a benchmark for defining UPSI such interpretation of materiality cannot be done arbitrarily. On comparing SEBI Listing Regulations and SEBI PIT Regulations, SAT observed that "*If entities resort to interpreting acquisitions by their sizes or magnitudes it becomes muddled as different parties will define the sizes and magnitudes and the relative ratios in their own ways leading to all round confusion and throw out regulatory certainty which is a cardinal requirement for an effective regulatory regime.*"On the point relating to disclosures by listed entities under SEBI PIT Regulations and Listing Regulations, SAT stated that "*A disclosure-based regulatory regime is founded on timely and adequate disclosure of all events material to a company or to its securities in any manner. Further hair-splitting will result in confusion; so the best way to deal with the event is to disclose without doing further analysis..... Therefore, in our considered view any event like a 100% acquisition of a company, irrespective of its value or size, is material and liable to bring in UPSI and consequently liable for regulatory compliances under LODR and PIT regulations.*"SAT partly allowed the appeal. While upholding SEBI's order w.r.t. non-compliance of PIT Regulations, SAT reduced the penalty amount from Rs. 5 lacs to Rs. 1 lac. SAT stated that minimum of penalty (as given in section 15HB of SEBI Act) is sufficient to meet the ends of justice.

Conclusion: The test of UPSI under SEBI PIT Regulations is likelihood of an event materially affecting price of the securities. Taking into consideration the amount of turnover, revenue, profits and assets of the listed entity, in my view,the acquisition of a company by listed entity's WOS is not 'material'. Pursuant to Regulation 30 of SEBI Listing Regulations, disclosures are divided into two parts: (i) Specified Events are deemed to be material events and disclosure is mandatory, and (ii) Disclosure of events shall be made based on application of the guidelines for materiality. SEBI has also prescribed 3 criteria for determination of materiality of events/ information. In addition to this listed entity shall frame a policy for determination of materiality, based on specified criteria. Such policy shall be duly approved by its board of directors, which shall be disclosed on its website. With so much disclosure requirement under SEBI Listing Regulations, it is necessary to align the materiality and disclosure requirements under SEBI PIT Regulations. Broadly, under both regulations, the purpose of disclosure is to ensure that material information is disseminated on time and the insider does not take an unnecessary advantage of such information.Regulation 8 and Schedule A to SEBI PIT Regulations relates to Code of fair disclosure and conduct and principles of fair disclosure for purposes of Code of Practices and Procedures for Fair Disclosure of UPSI. In the said provisions, there is no reference to materiality of information. Therefore, such alignment becomes inevitable.

SAT also admitted the fact that no designated person has benefited from the trades or that no one involved in insider trading of securities or no one else benefitted illegally during the period of UPSI in question [SAT order, Para. 17]. Therefore, none of the constituents of securities market have been affected by non-closure of window.

Another important issue w.r.t.timing of the disclosure of UPSI remains unclear. In the said case, the term sheet for acquisition was signed by listed entity's WOS on January 25, 2017 and share purchase agreement was signed on April 5, 2017. SEBI's AO has relied on an article in a newspaper to conclude that disclosure ought to have been made on January 25, 2017. On this SAT has observed that "*These are irrelevant for the issue under consideration since the trading window was never closed. In our considered view a UPSI existed prior to signing the SPA on April 5, 2017 and disclosed to the stock exchanges on the same day, and since the trading window was not closed there is a violation*". Based on this observation by SAT, it can be

inferred that disclosure for acquisition is required at the time of signing term sheet and not share purchase agreement. This observation by SAT has a wide impact on the compliances and disclosures by listed entity.

If the rationale of closure of trading (as applied in the present case) is extended, then even incorporation of a subsidiary companyor WOS becomes a price sensitive information which would require similar compliance. Taking these events into consideration and possible events in the lifetime of subsidiary or WOS company of listed entity, it can be said there should be provisions for 'opening of trading window' (rather than 'closing of trading window') in SEBI PIT Regulations.

In my view, the said information of acquisition by listed entity's WOS was not UPSI and therefore compliances under SEBI PIT Regulations were not warranted. The company fairly made disclosures under SEBI Listing Regulations following best practices and therefore, there was no ground for invoking non-compliance of SEBI PIT Regulations.To avoid all such issues, it is desirable that the disclosures and compliances under SEBI PIT Regulations and SEBI Listing Regulations are completely aligned.

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