31 December 2013

Comments on the Report of the High Level Committee to Review the SEBI (Prohibition of Insider Trading) Regulations, 1992

Background

In April 2013, the Securities and Exchange Board of India (SEBI) constituted a high level committee (Committee), under the chairmanship of Justice N. K. Sodhi, Former Chief Justice of the High Courts of Kerala and Karnataka and a Former Presiding Officer of the Securities Appellate Tribunal, to review the SEBI (Prohibition of Insider Trading) Regulations, 1992 (PIT Regulations). As a part of review process, the Committee had sought inputs and suggestions from public on any aspect of PIT Regulations.

CUTS International provided its inputs to the Committee in May 2013. The inputs provided by CUTS International are available at http://www.cuts-ccier.org/pdf/CUTS_Suggestions_on_SEBI_Prohibition_of_Insider_Trading_Regulations_1992.pdf

The Committee submitted its report to SEBI in December 2013. SEBI has invited comments from the public on the report. Comments from CUTS International on the report of the Committee are set out in the table below.

Comments from CUTS International on the report of the Committee

Sr. no	Draft provision	Comment	Rationale
1.	2(1)(f) – definition of generally available information	Insert words "with reasonable efforts," after the words "that is accessible"	As provided in the legislative notes to the provision, it is intended that information that is capable of being accessed by anyone without breach of any law would be considered generally available. For example, a person legitimately watching and counting the movement of goods from factories of a company and making his own analysis and assessment without involving a breach of the obligations under these regulations would be accessing information that is generally available. Now consider a reverse scenario, suppose company insider knew the details of movement of goods, however, no member of

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			public took an effort to count the physical movement of goods. The company has not made the information public, and the information is price sensitive. If the company insider trades on the basis of such information, as per the current drafting, the insider could argue that the information was generally available (although such information has not been officially made public by the company, but was capable of being accessed by anyone without breach of any law), and so there was no insider trading. However, this could not be regulatory intention. Thus, it is important to insert an effort qualifier to ensure that in case more than reasonable efforts are required to access the information, such information would not be termed as generally available information. Consider another scenario, a company's director is admitted to a hospital, the hospital guard notices this, as he is placed at the hospital. While such information is capable of being accessed by any member of public without breach of any law, it is highly unlikely that any member of public will access such information. Consequently, merely in order to prevent prosecution of a person who could have accessed price sensitive information unintentionally (and has other defences of no knowledge of such information being price sensitive), a huge unjustifiable

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			burden is being placed on the public to prove that such information was not capable of being accessed by a member of public. Consequently, the change suggested must be made.
2.	2(1)(g) – definition of immediate relative	Delete the words "any of whom is either dependent financially on such person, or consults such person in taking decisions relating to trading in securities"	The present draft of the regulation covers only those immediate relatives who are financially dependent on insider or consult insider to take decisions on securities trading. There might be situations in which insider consults immediate relative to take decisions on securities trading. For instance, a company peon might come across some information which might be price sensitive, but does not know the value of the information. While discussing the day with his independent and educated son, he mentions the information, and the son advises the father to trade on securities in a particular manner, or trades himself in that manner. In the current language, as the son is not financially dependent, nor is consulting his father to take decision relating to trading in securities (but the opposite is happening), he will not be caught within the definition of immediate relative. This should not be intention, and hence the suggested change should be made.
3.	2(1)(p) – definition of unpublished price sensitive information	Add the following to the illustrative list: "transactions other than in ordinary course of business"	Transactions that are undertaken by a company in ordinary course of business are generally not considered to be price sensitive. For example, for a real estate

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			company, acquisition of a property is in ordinary course of business and should not be considered price sensitive. There is a long list of precedents to support this assumption. However, transactions in other than ordinary course of business are more often than not price sensitive. Consequently, the suggested statement could be added to the illustrative list of information, which could be considered price sensitive.
4.	3(2) – procurement of unpublished price sensitive information	Add the words "or access to" after the words "by any insider of"	As per the current draft, a person is prohibited from: a) procuring unpublished price sensitive information from an insider b) causing the communication of unpublished price sensitive information by an insider However, there might be situations wherein a person may gain access to unpublished price sensitive information, without the insider being directly involved. For e.g. a person may gain access to an insider's laptop without the insider's knowledge. Such scenario might not be covered in the present language. In order to prevent any person from gaining access to unpublished price sensitive information in any manner, the suggested language should be added to the provision. This also corresponds to the words "allow access to" under regulation 3(1).
5.	3(3) – due diligence	Replace Regulation 3(3) with the following -	Combined reading of current draft of the clauses (i) and (ii)

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		"(3) (i) Notwithstanding anything contained in this regulation, it shall be legitimate to conduct due diligence on a company in connection with the assessment of any transaction where the board of directors of the company is of informed opinion that the proposed transaction and conduct of due diligence therefor are in the best interests of the company. (ii) The written justification from board of directors and the diligence findings that constitute unpublished price sensitive information must be disseminated, in a reasonably comprehensible form, to be made generally available at least two trading days prior to the proposed transaction being effected. (iii) In case a public statement about the transaction is required to be made in accordance with the applicable laws, the written justification and due diligence findings, as specified under clause (ii) above, must form part of such public statement"	reveals that whether or not there is an obligation to make an open offer, due diligence will be allowed if the board of directors is of the informed opinion that the transaction and diligence are in best interests of the company. Consequently, clauses (i) and (ii) could be merged and simplified to that extent. Thus, the suggested change should be made. In addition, it would be useful if the legislative notes could explain what 'informed opinion' means. While note to current clause (ii) provides that due diligence will be permitted if board of directors are able to justify its necessity, there is no provision to make the justification public. It would be necessary to make the written justification available to public, and hence the suggested change should be made. The justification and the due diligence findings must be made public even when the transaction triggers open offer obligations under the takeover code, and this should be explicitly stated.
6.	New provision – exemption from regulation 3(1)	Add the following provision: "3(5) It shall be open to the insider who communicated, provided, or allowed access to any unpublished price sensitive information to any person to demonstrate as a valid defence that such insider had no reason to believe, exercising diligence expected of a reasonable person, that such information was unpublished price sensitive	The proposed regulations have substantially expanded the scope of 'insider' and any person associated with a company in any capacity can be potentially considered an insider. In such a situation it is necessary that innocent recipients of inside information are not prosecuted under the regulations. Consequently, the suggested provision must be included.

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		information"	This is also corresponding to the exemption provided under current regulation 4(3)(ii), in relation to trading of securities by an innocent recipient of unpublished price sensitive information. The same must be extended to communication of unpublished price sensitive information.
7.	New provision – additional exemption from regulation 4(1)	Add the following provision: "4(3)(viii) the trades were made to meet an emergency."	There might be situations during which a person is required to transact in securities to meet an emergency (See SAT decision of Rajiv B Gandhi and others v. SEBI, dated 09.05.2008). Such transactions must be allowed to maintain efficiency and utility of capital markets, subject to justifiable explanation regarding existence of emergency.
8.	4(3)(v)(b) – exemption to non-individual insiders	Add the words "provided, or allowed access to", after the words "information was communicated"	This suggested change is to ensure consistency between regulation 4(3)(v)(b) and regulation 3(1).
9.	6(2) – disclosure by immediate relatives	The scope of regulations 6(2) and 2(1)(g) should be same.	At present, the immediate relatives definition covers only those close relatives who are either financially dependent on insiders or who consult the insider in taking decisions relating to trading in securities (2(1)(g)). However, disclosures of trading in securities are required to be made by all the immediate relatives of the employees, and by any other person for whom such employee takes trading decisions. The scope of disclosures of trading and immediate relatives covered under the regulations must be same, hence the suggested change is required.

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10.	Global comment	Use gender neutral language and avoid archaic words (such as shall), and use simple words (such as must).	A high quality draft use gender language and plain, simple and easy to understand words. This trend is being followed by regulators in other jurisdictions also.

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