SECTION II – INFORMAL GUIDANCE

SEBI INFORMAL GUIDANCE IN THE MATTER OF HDFC BANK LTD

Introduction

Pursuant to the SEBI (Informal Guidance) Scheme, 2003 (Informal Guidance Scheme) the Securities and Exchange Board of India (SEBI) has responded to a request for an interpretative letter dated 26 May 2016 (Letter) made by HDFC Bank Limited (Bank). The Letter clarifies SEBI's interpretation on the applicability of Regulation 4 of the SEBI (Prohibition of Insider Trading Regulations), 2015 (Insider Trading Regulations) on investments made by a discretionary portfolio manager on behalf of the Bank's employees or their relatives (Investors) when:

- such Investors have no control over investment making decisions and are in possession of unpublished price sensitive information (UPSI) of the Bank or of listed companies with whom the Bank deals; or

- the trading windows of the Bank or the listed companies with which the Bank deals, are closed.

It was submitted by the Bank that a discretionary portfolio manager acts independently and does not discuss potential investments or disinvestment decisions with the Investors and the Investors also do not make any suggestions to the discretionary portfolio manager regarding specific investment or disinvestment decisions prior to their execution. The Bank has provided analogous examples with investments in mutual funds (where investment managers make independent decisions about investing in specific securities) to those under a discretionary portfolio scheme and have argued that investments under a discretionary portfolio scheme should enjoy similar exemption as those available to mutual funds under the Insider Trading Regulations. The Bank has also indicated that as a precautionary measure, it procures declarations from its employees that they do not have any direct or indirect influence or control over the specific securities selected by the discretionary portfolio manager.

Regulatory provisions

As per the SEBI (Portfolio Managers) Regulations, 1993 (Portfolio Managers Regulations), a discretionary portfolio manager is one who exercises or may, under a contract relating to portfolio management, exercise any degree of discretion as to the investments or management of the portfolio of securities or the funds of the client, as the case may be. Further, as per the Portfolio Managers Regulations, a discretionary portfolio manager "shall individually and independently manage the funds of each client in accordance with the needs of the client in a manner which does not partake character of a mutual fund…".

As per Regulation 4(1) of the Insider Trading Regulations, no person shall trade in securities that are listed or proposed to be listed on a stock exchange when in possession of UPSI. Further, Schedule B of the Insider Trading Regulations mandates closure of the trading window when designated persons can be expected to be in possession of UPSI.

SEBI's view

SEBI issued the Letter on 25 July 2016, stating that Regulation 4(1) of the Insider Trading Regulations when read with the explanatory note, set out the premise that trading in securities by an insider while in possession of UPSI would be presumed to have been motivated by the knowledge and awareness of such information in his possession. SEBI therefore held that, the manner of such trading (whether direct or indirect), including through a discretionary portfolio manager, is not relevant and any trading while in possession of UPSI would be presumed to be motivated by such knowledge of UPSI. SEBI has further indicated that in accordance with section 4 of Schedule B of the Insider Trading Regulations, dealing by Investors in the securities of the Bank or of the companies that they deal with, through a discretionary portfolio scheme when the trading windows are closed shall also be assumed to be motivated by knowledge and awareness of the UPSI.

Comment

A discretionary portfolio manager acts on the basis of a contract by way of which he is appointed. While discharging the duties of a discretionary portfolio manager, he has the ability to make decisions at his own discretion but that does not preclude him from engaging in discussions with the Investors.

Therefore, one cannot rule out the passage of UPSI in the course of communication with such a discretionary portfolio manager. In light of the same, it can be said that a discretionary portfolio manager exercises *discretion as against independence* which is applicable in the case of a mutual fund manager. Accordingly, since the role of a discretionary portfolio manager is not purely independent and he has the right or option to interact with the Investors, his ability to act on the basis of UPSI cannot be ruled out. By way of this informal guidance, SEBI has ensured that discretionary portfolio schemes are not used as means of indirect dealings in securities by Investors, while in possession of UPSI.