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Analysing developments impacting business

THE "INSIDE" TALE OF ENHANCED ACCOUNTABILITY, COMPLIANCES AND DEFENCES

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The Securities and Exchange Board of India (SEBI) delivered on its commitment to bring transparency, objectivity and consistency to the SEBI (Prohibition of Insider Trading) Regulations 2015 (Insider Trading Regulations) while implementing recommendations of the Report of the Committee on Fair Market Conduct of 8 August 2018 under the chairmanship of Dr T K Viswanathan (Committee), by way of the SEBI (Prohibition of Insider Trading) (Amendment) Regulations 2018 (Amendment Regulations) that will be effective from 1 April 2019.

Key Changes Impacting M&A Transactions

- Interpreting the "Legitimate Purpose" Exemption: The Insider Trading Regulations exempt communication of unpublished price sensitive information (USPI) in furtherance of a fairly nebulous "legitimate purpose". Though this phrase remains undefined, the Amendment Regulations illustrate it to include sharing of USPI in the *ordinary course of business*. This, to an extent, assists in the interpretation of the phrase to permit sharing of USPI for business requirements. The onus, however, remains on the board of directors of the listed company (Boards) to formulate and publish the policy for determination of "legitimate purpose".
- Applicability to Unlisted Companies: The Amendment Regulations have clarified that the Insider Trading Regulations now apply only to those unlisted companies that have filed (i) offer documents or other documents with the SEBI, stock exchanges or registrar of companies in connection with its listing; or (ii) copy of a scheme of merger or amalgamation (with the intention of getting listed) under the Companies Act 2013.
- Form of Non-Open Offer Trade Disclosures: The Amendment Regulations now specify that USPI, which is made available to select persons after complying with the process set out under the Insider Trading Regulations and in connection with transactions that do not entail a mandatory open offer under the Indian takeover regulations, should be communicated to public in a form that is '*adequate and fair to cover all relevant and material facts*'. Henceforth, Boards would need to adhere to these guiding principles while disseminating USPI to public in such circumstances.

Defences and Clarifications

- Assumption of Abuse: The law now presumes that a person who trades in securities while in possession of USPI is motivated by knowledge and awareness

of such UPSI. This burden has to be discharged by the concerned person. However, the SEBI has expanded defences available in such circumstances as set out below.

- Symmetric UPSI Trades: The Amendment Regulations now provide as a defence that insiders (and not just promoters) holding symmetric UPSI that is obtained by complying with the Insider Trading Regulations can undertake off-market trades and block deals while in possession of such UPSI. However, these defences are unavailable where UPSI is made available to such insiders pursuant to the process permitted for communication of UPSI in relation to 'a transaction' (whether or not such transaction triggers a mandatory open offer under the Indian takeover regulations).
- Regulatory Obligations, and Stock Options: Similar defences are provided for trades done pursuant to statutory or regulatory obligation to carry out a *bona fide* transaction, or in exercise of stock options where exercise price was pre-determined in compliance with applicable regulations.
- Trading Plans and Contra Trade: To make 'trading plans' robust, the Amendment Regulations clarify that pre-clearance of trades, trading window norms, and restrictions on contra trade will not apply for trades that are carried out in accordance with an approved trading plan.

Enhanced Accountability and Compliance

- Broader Applicability of, and Separate Codes of Conduct: The code of conduct was previously prescribed for trades by employees and connected persons designated on the basis of their functional role in the organisation. The code of conduct is now applicable to 'designated persons', and 'immediate relatives' of such 'designated persons' only. Boards are required to specify 'designated persons' based on their functional role, which should *inter alia* include employees (including of material subsidiaries), promoters, CEO and up to two levels below the CEO and support staff having access to UPSI. Further, disclosures of trades in excess of INR 1 million is now applicable to designated persons (in addition to promoters and directors).
- Separate Codes of Conduct and Concept of 'Fiduciary': The Amendment Regulations also now prescribe two separate codes of conduct – one for listed companies and the other for intermediaries, fiduciaries and every other person required to handle UPSI in the course of business operations, considering the nature of business of each market participant. The Amendment Regulations use the nomenclature 'fiduciary' for professional firms such as auditors, accountancy firms, law firms, analysts, insolvency professional entities, consultants, banks and the like that assist or advise listed companies, and require them to formulate a code of conduct (similar to the code applicable to intermediaries) for regulation of trading by their 'designated persons' and such designated persons' 'immediate relative'.
- Enhanced Internal Controls: Changes which would possibly be viewed as tedious but seek to enhance governance standards in the long run, include:
 - identification of employees with whom information is shared, and execution of confidentiality agreements, etc, and maintenance of digital database containing the names of such persons or entities with whom information is shared in connection with a transaction;
 - designated persons to disclose their past employers and educational institutions; names, permanent account number, mobile number and the like of their 'immediate relatives' and persons with whom they share a 'material financial relationship' to the company annually (where 'material financial relationship' means a relationship in which a person receives any kind of

payment such as by way of a loan or gift during the immediately preceding 12 months, not on arm's length basis and equal to or more than 25% of such payer's annual income);

- policy to deal with leak of UPSI including whistle blower policy, and to conduct prompt inquiry upon becoming aware of such leak.

Boards and audit committees are required to ensure compliance with, and review of, these requirements under the Amendment Regulations.

Conclusion

As the Indian financial market matures and becomes increasingly complicated with heightened risk of abuse of information, the regulator, known for its superior surveillance processes, has offered several pragmatic changes. Having said this, only time will tell how effective the new enforcement mechanism would be.

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