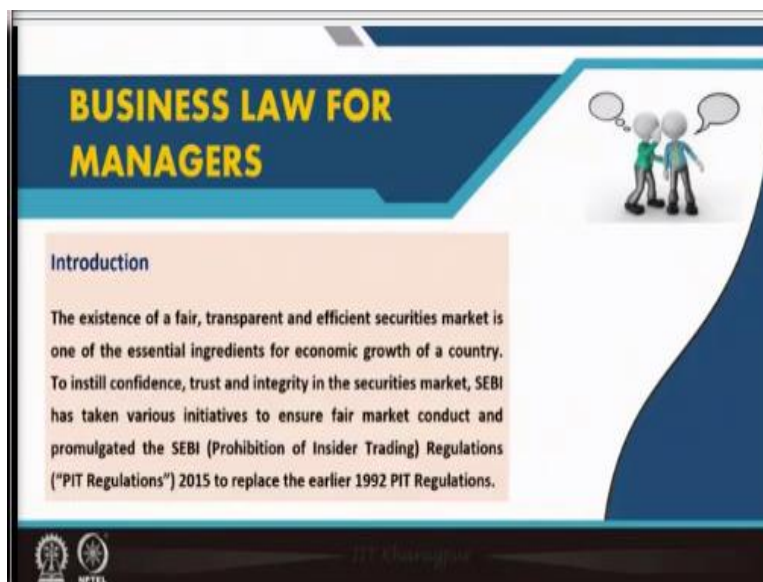


Business Law for Managers
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Module-3: PIT (Prohibition of Insider Trading)

Lecture-11
Concept, Scope and Features of PIT

Good morning, we are starting lecture 11 on concept, scope and features of PIT. PIT stands for prohibition of insider trading regulations.

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Now the whole concept of prohibition of insider trading a regulation which was brought about in 1992 was replaced in 2015 because of the reason that the 1992 act was more of an awareness kind of thing. And it was more into awakening of what can tantamount to insider trading. It was a guiding but that act did not have much teeth in it nor this act was actually looking into the nuances of the nitty-gritties of fine insider trading practices which started with the help of digitalization, with the help of technology. Where to get into the route was becoming a challenge and again even if you are going to the route to established the violation or the crime was becoming difficult in view of the provisions of the law that in time, so 2015 act came into play.

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KEY POINTS

- Background of Prohibition of Insider Trading (PIT)
- Scope
- Salient features
- Disclosure of trading by Insiders
- Trading plans

The slide features two inset images: one of a man in a suit talking on a mobile phone, and another of a man in a blue shirt looking towards the camera. The slide also includes logos for IIT Bombay and NPTEL at the bottom left.

Whenever we talk of insider trading 2 words come into play, who is an insider and what is trading? And why there should be a prohibition? Many times, question is asked what is the need of prohibiting of trading. Trading of shares is always healthy, there will be demand, there will be supply, more the liquidity the better it is for the company, for the stakeholders, for everybody, for the investors. It is not the question of prohibition of trading, trading is most welcome but trading by insiders has to be prohibited. Who are insiders and why it is to be prohibited?

Insiders are person in one small definition of insider there may be a huge definition of insider connecting all the dots. But the basic point is anybody who has access to unpublished price sensitive information, anyone under the sun who has access to unpublished price sensitive information. So, if we have to go to that length, we have to go to the next slides to understand what it tantamounts to? We will see the scope, the salient features, the disclosure of trading by insiders and trading plans.

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Prohibition of Insider Trading (PIT) Regulations

Background

Committee chaired by former Chief Justice Mr. N.K. Sodhi, which made a range of recommendations to formulate an effective legal framework to prohibit insider trading in India. Based on the recommendations made by the Sodhi Committee, SEBI (Prohibition of Insider Trading) Regulations, 2015 (hereinafter referred to as "PIT Regulations, 2015") came into force on 15th May, 2015.

This is more of a preparatory ground for 2015, recommendations were there, truth committee actually it is called the Sodhi committee not because that chief justice Mr. N.K. Sodhi was heading that committee. And various case laws, case studies were placed which unfolded that 1992 act was unable to take care of those. So, the need of the hour was to bring a more robust definition of insider, earlier the definition of insider was restricted to the employees, the directors, those who are connected to the employees and directors in some way or the other.

But the 2015 definition of insider is anybody who is possessing or access not possessing or access to unpublished price sensitive information. If for any reason somebody is having information by his role in a company and he is sharing their information also because of his role to somebody, so that person also becomes an insider. Earlier definition would have restricted it to the person who has been authorized to have this information. But while he was sharing in the course of his work in the discharge of his duties was not really coming into 1992, now 2015 brought it under. Anyone who is having access to that information whatever be the reason will become an insider.

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Prohibition of Insider Trading (PIT) Regulations

Definitions under SEBI (PIT) Regulations, 2015

- "Act" means the Securities and Exchange Board of India Act, 1992;
- "Board" means the Securities and Exchange Board of India;
- "Compliance Officer" means any senior officer, designated so and reporting to the board of directors or head of the organization
- "Connected Person" means, –
Any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity

Certain further definitions were brought in. Compliance officer who is always the company secretary of a company. Being the company secretary, his role has expanded like anything, today he is the custodian all the records, he is a custodian of all the recording some minutes, he is also an officer who has to ensure that the insider trading regulations, prohibition of insider trading regulations are followed.

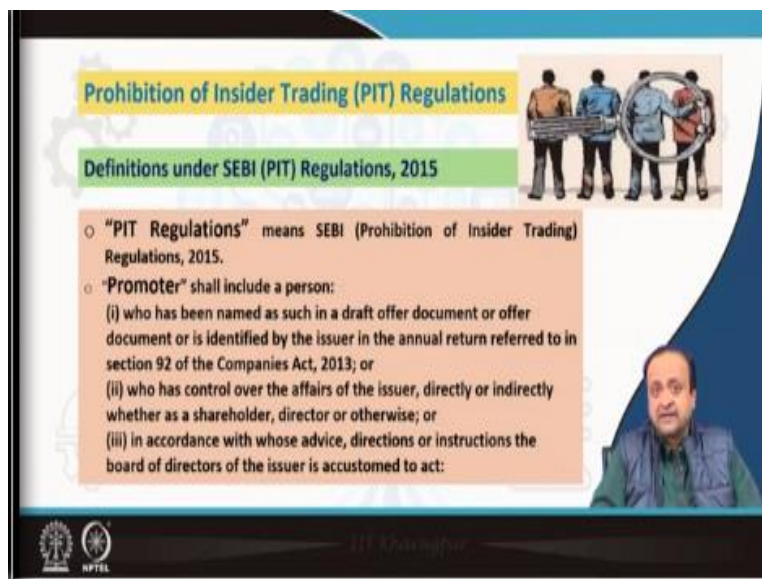
And any violation deviation he has to report to the stock exchange, his responsibility is to report to the stock exchange. We find today so many disclosures by companies saying that ex-employee has traded in the shares of the company and that employee has not disclosed that before trading. Neither he has submitted a trading plan; however, he has now disclosed that he has traded with the shares, so this is for the information of the stock exchange.

The company is further investigating the matter to find out if there is any financial gain even if there is no financial gain. Whether he was in possessing of any unpublished licensing information during that time, necessary action as per the code of conduct of the company will be taken. There was no need of this disclosure before in 1992, 2015 made it mandatory. There are examples where senior officers of the company before they buy the shares of the company never used to inform the compliance officer of the company secretary.

Now if they do not do, they run the risk because all their pan numbers are had to be manually submitted to the regulatory body through the registrar. There is a registrar; there is a controlling body which collects the pan number of all the employees, senior most employees whose names have been given by the compliance officer. These are the persons who are the designated persons who are supposed to have access to unpublished price sensitive information.

This list has to be prepared and given to the regulator along with their pan numbers including their spouse's pan number. So, from there SEBI can track whether their trading has happened or not and therefore so many cases are now coming up. That you have traded in the shares of the company, please explain was the trading window open? Did you take the permission of the compliance officer? Was it as per the trading plan and copy given to the company to also respond? So, tracking of those trades have become easier now because of the information flow that is happening.

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Prohibition of Insider Trading (PIT) Regulations

Definitions under SEBI (PIT) Regulations, 2015

- "PIT Regulations" means SEBI (Prohibition of Insider Trading) Regulations, 2015.
- "Promoter" shall include a person:
 - (i) who has been named as such in a draft offer document or offer document or is identified by the issuer in the annual return referred to in section 92 of the Companies Act, 2013; or
 - (ii) who has control over the affairs of the issuer, directly or indirectly whether as a shareholder, director or otherwise; or
 - (iii) in accordance with whose advice, directions or instructions the board of directors of the issuer is accustomed to act:

Definition of promoter has been widened here, anybody having control over the affairs directly indirectly whether the shareholder director or otherwise, the control aspect has come into play. Instructions of the board whose accordance with the instructions of board, the board is accustomed in accordance of whose services directions and instructions the board of directors of the issuer is accustomed to act, so he is the chairman of the board of directors. As promoter

means normally, he also has the control over the management of the company by holding the position of a chairman.

So, if somebody is whose direction instructions the board of directors is accustomed to act, then he becomes a promoter, not that he has to hold shareholding only. Even if he is somebody who is controlling the directorship of the company, majority of the directors then also he becomes a promoter. All these definitions are coming because to hold the promoter also responsible for insider trading. Then you are a designated person, you are access to information, be careful that there is any trading in shares which is violation of insider trading regulations then you will be penalized for that.

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Prohibition of Insider Trading (PIT) Regulations

Definitions under SEBI (PIT) Regulations, 2015

- **"Insider"**
Any person who is (i) a connected person; or (ii) in possession of or having access to unpublished price sensitive information ("UPSI"). Every connected person is an 'insider' under the Regulations.
- **"Trading"**
Trading under the Regulations has been defined to mean and include 'subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities.'

This is exactly what was disclosed; I mean discussed that in possession of access to unpublished price sensitive information. Now we will go to unpublished price sensitive information, what is the price sensitive information and what is an unpublished price sensitive information? Basically, a price sensitive information would mean something which can affect the share prices of the company in the bosses.

Any information which can affect, have an effect on the prices of the shares in the market, that is called a price sensitive information. Now when it becomes unpublished, when it is not published in the public domain? And how it remains unpublished, we will discuss as we unfold. Trading,

trading actually means buying, selling, dealing, agreeing to subscribe even agreeing to subscribe, agreeing to buy, agreeing to sell that happens to trading.

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Prohibition of Insider Trading (PIT) Regulations

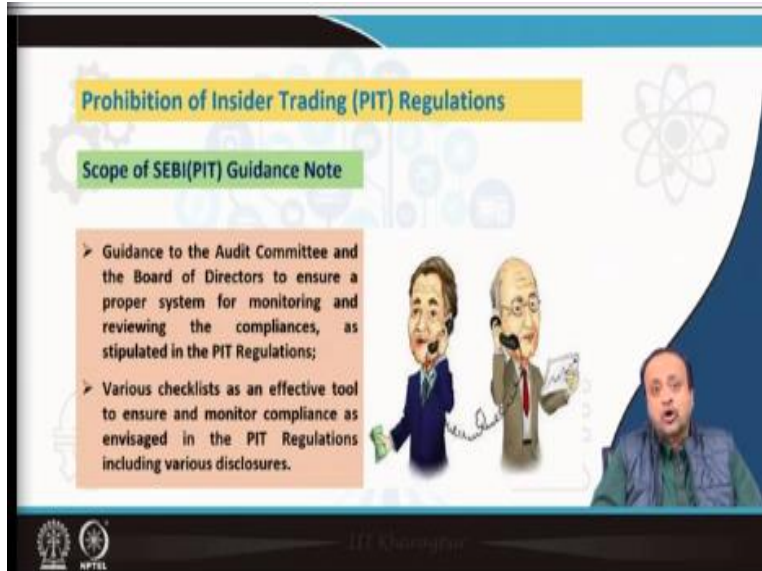
Scope of SEBI(PIT) Guidance Note

The PIT has scope on guidance as noted below:

- Guidance on various aspects of Prevention of Insider Trading and explains the SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations), as amended, where required;
- Guidance on ensuring the compliance of the PIT Regulations by the listed companies, intermediaries, fiduciaries etc.;
- Guidance on best governance practices for implementation of the PIT Regulations;

PIT regulations clearly specified certain do's and don'ts for the companies, what the company would do? What the company would not do? The first thing the company would do is to prepare a code of conduct; we call it a model code of contact. For all companies should have a code of contact for the employees to know when they can buy the shares. When they cannot buy the shares? What they will do if they buy the shares? Whom they would inform if they buy the shares? So, this is called a model code of contract, it is a duty of the company secretary is the compliance officer to have this circulated. And also have it in the company's website, so that all employees can have access to that information.

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The audit committee of the board again very important provision of 2015, the audit committee and the board of directors should ensure there is a proper monitoring and reviewing of the compliances. So, is no longer restricted to the managing director and the company secretary and the KMPs, the board of directors are now looking into it. The audit committee is now looking into to ensure that there is proper monitoring and reviewing of the compliances.

Various checklists have been given have been prepared by the regulator and also have been recommended by the regulator, one of the checklists also consists of the trading plan. If you want to buy the shares of the company on a regular basis, no harm, give in advance notice that this many numbers of shares I will pick up in the first 3 months, 6 months this many and the next 1 year I will pick up these shares, your trading plan should be there. Now you might say, sir, why do I pick up the shares or why should one pick up the shares if he is not knowing how the company will perform?

Well, that is speculation, you are an employee of the company, you have access to price sensitive information if you want to buy, give your trading plan in advance. You cannot see the performance of the company and then have information in your hand and then buy and sell. Anybody who is a designated person having access to price sensitive information should give a trading plan to the company. Come whatever may this is what I am going to buy during the year and that trading plan is to be disclosed to the stock exchange.

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Prohibition of Insider Trading (PIT) Regulations

Salient Features

- The regulations have strengthened the definition of who an insider is by expanding the definition of connected person.
- Every connected person under the regulations is an insider
- The regulation has further defined the term generally available to mean that is accessible to the public on a non-discriminatory basis
- Trading under the regulations has been defined clearly
- The regulations have introduced a definition for a compliance officer of the company

Connected persons, the new concept which is brought in, example I was giving you have got access to unpublished by sensitive information as per your role say company secretary or a CFO. Now he shares that information with his team, team meaning the team of accountants of the team of compliance officers. The designated person list into the 1992 would have restricted themselves only to the company secretary.

Now 2015 act says all the connected persons, if he is sharing this information with the registrar, the registrar also becomes an insider. If he is sharing this information which is secondary the secretary also becomes an insider. If he shares his information with his junior management trainee his management training also becomes, now why he is sharing? What profile is like that it has to be shared?

All information cannot be kept by 1 person and then compliance can be done, somebody has to be, some 1 or 2 persons have to have also that confidential information along with that company secretary, so all these persons also become connected persons. Same in finance department, accounts are prepared, results are prepared, you cannot think the CFO only has the information and the number 2, number 3 or further people down the line do not have the information, the treasury head does not have the information, cannot happen.

A finance of a manufacturing company at least 10 to 15% have privy to that confidential information, what is coming out, what is the result going to be, what will be the PVT, what will be the pat, what will be the dividend amount? Some kind of idea they will be having, may not be the exact amount because dividend is never known before it is recommended by the board of directors.

But looking at the PPT they can find out, everybody has that much maturity in the finance department to find out what is going to happen. So, they always have that information, the person who is preparing the cost records of the company. The cost accountant the entire internal audit team for example. The entire internal team including that junior most employee has privy to that information, so he is also a connected person. He will be also considered a person who is an insider and has access to unpublished price sensitivity information.

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Prohibition of Insider Trading (PIT) Regulations

Salient Features

- The regulations contain a specific carve-out for communication and procurement of information
- The regulations have introduced the concept of trading plans to facilitate compliant trading by insiders
- The regulations sets out the initial and continual disclosures to be made by certain categories of persons in a company whose securities are listed on a stock exchange
- The Board of every listed company is required to formulate and publish a code of practices and procedures to be followed for fair disclosure of UPSI

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Where trading plans is a new concept which is common but has not become very popular. Trading plan has not become a very popular, people are shying away from buying the shares of the company, they are saying it is better I do not buy then I disclose what I am going to buy because they are also feeling that it might lead to further investigation.

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Prohibition of Insider Trading (PIT) Regulations

Initial Disclosure of Trading

- Every promoter, member of the promoter group, key managerial personnel (KMP) and director of every company whose securities are listed on any recognised stock exchange shall disclose his holding of securities of the company.
- Every person on appointment as a KMP or a director of the company or upon becoming a promoter or member of the promoter group shall disclose his holding of securities of the company

This is something very important, every promoter member of the promoter group, key managerial personnel, who is the key manager personnel? 3 persons are key manager personnel, the managing director, the company secretary and the CFO. They have to declare their shareholding to the stock exchange. On a particular date they will disclose and if there is any increase or decrease, they have to inform.

Because they are considered to be the most important insiders, they are privy to the core unpublished price sensitive information. The core, the results are prepared, the final results are deliberated, recommendations come from the board, chairman has his observations, senior most independent director may give his observations, chairman of the audit committee who is an independent director may give his observations, all these observations are restricted only to 3 persons.

These do not percolate down, these are restricted in all companies' large companies to 3 persons the managing director, the company secretary and the CFO. So, since they are the truest, I try to call them the truest insiders of a company. So, these truest insiders have to disclose their holdings. And if there is any change in KMP anybody taking **of** over the position of a KMP has to disclose that, change in a promoter group has to be disclosed.

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Prohibition of Insider Trading (PIT) Regulations

Continual Disclosure of Trading

- Every promoter, member of the promoter group, designated person and director of every company shall disclose the number of such securities acquired or disposed of if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified
- Every company shall notify the particulars of such trading

Restriction is, the cap has been given 10 lakh of shares or such other value has been specified. Now these 10 lakhs is what the semi has prescribed, some companies has restricted it to 5 lakhs, value of shares, it is not the face value, it is the market value of shares, traded value of the shares. So, if a share value is 1000 rupees traded in the market it is face value can be 10 rupees, so it is talking of the traded value 1000 rupees, any calendar quarter, then you have to inform, disclose or even if you dispose of that also is to be disclosed.

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Prohibition of Insider Trading (PIT) Regulations

Trading Plans

Every insider is entitled to execute trades in pursuance of pre-determined trading plan having key features as follows:

- Trading plans shall not entail trading for a reasonable period around declaration of financial results;
- Trading plan shall not entail trading for at least 12 months since the date of decision to trade;
- There shall not be any overlap with another trading plan already in existence.

So, trading plan is something as I told you the reasonable period in which the trading will take place, normally it is a period of 1 year. You have to trade; you have to give a plan of what you are going to do or buy and sell of the shares in the next 12 months.

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Prohibition of Insider Trading (PIT) Regulations

Trading Plans

- Trading plans that entail trading in securities for market abuse is prohibited;
- Trading plans must set out nature of trade, value of securities or the number of securities to be invested or divested, specific dates and time etc.;
- The compliance officer is entitled to review the trading plan and seek express undertakings that may be necessary for such assessment/monitoring and notify the stock exchanges on which the securities are listed, once the trading plans are approved;

The compliance officer is entitled to review the trading plan, so it is not very rigid, some companies may make it 6 months, some companies make it 3 months. But whatever is made known to all in the company, this is where the company and the management can be at a risk. If it can be proved that this trading plan or this model or this code of conduct has not been disclosed properly.

It is not available in the website of the company, any new joinee who joins an organization. It is the job of the HR to ensure that he takes a declaration from him that he has read and understood all the provisions of various regulations which are prescribed and mentioned in the website of the company. Companies have strong HR basis, they get a tick mark from them, giving a box where he has said I have read regulation, this I have read regulation, that, so all the regulations are to be actually made aware and he should also give a declaration that I have read.

Not only that, these designated persons every year, month end, every year end that is by 31st march have to give a declaration in the code of conduct that we have abide by the prohibition of insider trading regulations, every year, religiously. Some companies do it even 6 months, that compliance of the prohibition we say, what happens? The moment given a paper to you to sign, a senior most employees may be the vice president marketing or the executive data marketing or the director, manufacturing, they are busy in their own way, whole year.

But when you give a paper to him that this declaration has to be given to the board of directors of audit committee, he becomes alert. His conscience also picks him, have I bought any shares? Have I sold any shares? I have to disclose that. It is very common in corporates it happened and being the compliance officer, many times people come and running at you that I purchase certain shares I forgot to disclose, what should I do? So, it is always better to get a declaration from them, so that they do not miss out and later on end up into difficulties.

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Prohibition of Insider Trading (PIT) Regulations

Trading Plans

- Once approved trading plans shall be irrevocable and the insider shall mandatorily implement the plan within the scope of the trading plan, without any deviation;
- Commencement of the trading plan will be required to be deferred in a situation where the insider is in possession of UPSI at the time of formulation of the plan has not become generally available at the time of commencement of the plan.

Because SEBI is tracking, SEBI has a robust tracking mechanism, earlier people were thinking that if I buy and sell who is going to track me? Now it is being tracked and therefore you are fine, so many companies are coming out with disclosures given by their own employees saying that yes, a mistake has been made. I have purchased the shares, I have not informed, I have sold the shares at this price, is the profit I have made.

Sometimes they pay back the amount, sometimes the penalty amount is paid and everything is informed to the stock exchange, this action the company has taken. There are plethoras of examples in the stock exchange information site where companies are giving this kind of information, good companies; companies who are rated highly even there these cases are misses are happening.

I understand category b, category c, rating category I am talking of but even category a rating companies are also giving disclosures, yes, they have been slips and misses. What was the need of giving that? The need is it is being tracked.

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It is always very important to understand that insider trading regulations has proved to be extremely useful in disciplining corporate. From my personal experience I can say that I have come across lot of case studies in which I have seen a discussion in the board instead of getting into both discussions goes sometimes into decision of how a particular company is doing? What is the worth of that company? Is it being it good to remain invested in the company?

Board meetings are earlier years in the board meetings normally discussions used to take place religiously on investments. Today that has stopped totally, because first of all board meetings discussions are recorded, second this type of discussions are totally prohibited. Board of directors are actually persons who have got huge insider information, why? Because it is not, he is sitting in the board of that company only, he is sitting in the board of various other companies.

He may be a banker, he may be a charter accountant, he may a management consultant, he may be a lawyer, he may have so many clients, he may be so many other areas to a specialization. So, he is a reservoir of information and most of these informations are unpublished information.

Many times, inadvertently this is shared but that inadvertence can never have an effect of an exemption.

So, many cases we have seen even to the extent of a very senior legal counsel of a multinational company, she has sharing information with her husband. On a case in which she guided and on her guidance the company came out victorious in that matter. But while sharing she passed on some information which was not known to the public, that they were trying to acquire some shares of another company. Acquisition is one of the most confidential informations.

Husband while discussing with his friend who was a broker, pass on this information whether inheritably or deliberately is immaterial. But that broker made lot of money from that transaction and it was also shared with that husband. The lady lost the job, not only the job both the husband the lady and the friend faced investigation, penalty, image, social status, all. So, as they say then even information like this cannot be shared with your partner, we have today employees working in different competition.

Husband working in one company, wife working in another company and they are in competition, it can happen and is happening, so what is the case? Will the husband resign or the wife resign or both of them resign or both of them continue? Now legal advice would be considering prohibition of insider trading regulations, very clearly specifies, you disclose that. Both should disclose that my spouse is working in competition in this position for so many years and the other also would say my spouse is working in that.

By giving the disclosure they have protected themselves. Even after this if the company allows them to work in their respective fields, it is the responsibility of the company to create that ambience of that circle of security of confidentiality that they do not have access to unpublished price sensitive information. But this couple would always run under the scanner of the SEBI, why because if there is any inadvertence also from their side, their disclosure would not help them.

They have to ensure that no disclosure takes place and even if the disclosure takes place ensure that is disclosed to the stock exchange immediately, today there is no choice. On prohibition insider trading regulations, there are discussions which are going on even to the extent of whether it is at all required for the employees of the company who are having a certain designation or at a certain level at all invest or by the shares of the company.

Why go into any kind of unnecessarily investigations of the company as well as the employees? One end makes it a policy that if you are an employee of the company, you will not buy the shares of this company as long as you are the employee neither you nor your spouse or your near relations. By the process the company is not affected, it is otherwise a healthy pool of liquidity, the company is no problem; company has no problem if 10, 15, 20, 100 or even 1000 employees do not buy the shares.

But the company avoids the risk of insider trading to some extent. Prima facie it has done of a good policy, it has come out with a good policy, some companies are coming out. At a certain level all companies have mostly come out. Senior management, departmental heads, board of directors stay away from the shares of the company, do not at all buy the shares of the company.

And if you are already holding hold on to that share, do not sell it. If you really have to sell it, take the permission sell it once and then again do not buy it. So, this is how the act is becoming stricter and stricter. Even to the extent of not only buying the shares of the company, shares of the company of the sister companies, associate companies. I know of a case of a conglomerate, where the managing director of a particular company wanted to buy the shares of another company which is in the same group and he sought permission from the compliance officer of that company.

And the compliance officer said as per law you are absolutely ok to buy but as per our company policy you cannot buy the shares of the company. But since this is not a company, however this is a sister company or associate company in which there is common shareholding, common control, hence it is advisable to stay away from the shares of the company.

Few days back SEBI has come out with another amendment stating that persons who are at the board level and who are at the decision-making level particularly the promoters and directors should stay away from the shares of the group companies or sister companies. It is advisable SEBI has used the same word, should stay away, ideally, not forcing them but giving them a guidance, stay away.

So, buying shares or selling shares of other companies in which you are not connected is absolutely fine. But in the company where you have got information unpublished price sensitive information, information which has got impact on the share prices can have. Example, some expansion plans, some diversification plans, some acquisition plans, some raising of fund's issues, some mergers, some amalgamation.

Even information like closing down of a unit, negative information but still an information, resignation of a CFO or a managing director is an information, very important price sensing information. It is not that only increase in prices, even decrease in market prices would have a crash on the market prices. All these would remain unpublished unless you inform the stock exchange immediately on happening.

Many times, this information are not immediately informed because there is a concept of informing those informations which are material for price sensitive, material to have a material effect on the price. If the board of directors feels that it will not have a material effect on the price then they can still say, well, it is not a material price sensitive information, hence no need to disclose.

But though it is not material but it is a price sensitive information and you are sitting on that information you are only privy to that information. Therefore, for any reason if you trade in the shares or your relations trades in the shares during that time you are actually violating the law. When a company thinks of expansion or diversification or acquisition the process starts much before the happening, it may take 1 year, it may take 6 months.

But in the board meetings these discussions takes place maybe 1, 2, 3, 4 board meetings happen and then the company enters into an MOU or company enters into some kind of understanding and then the company thinks this is the right time to inform the market. Before that the company also was not sure whether it is going to happen, it was a stage of deliberation, negotiation, information gathering.

When you go for acquiring a company the first thing you do is do a due diligence. And due diligence of the financial matters, due diligence of the business matters for that time you create an own core group and ask them to find all information about the company. And then after getting that information you place it before the board, board of directors are apprised that this is what you are planning, shall we go ahead? Give direction.

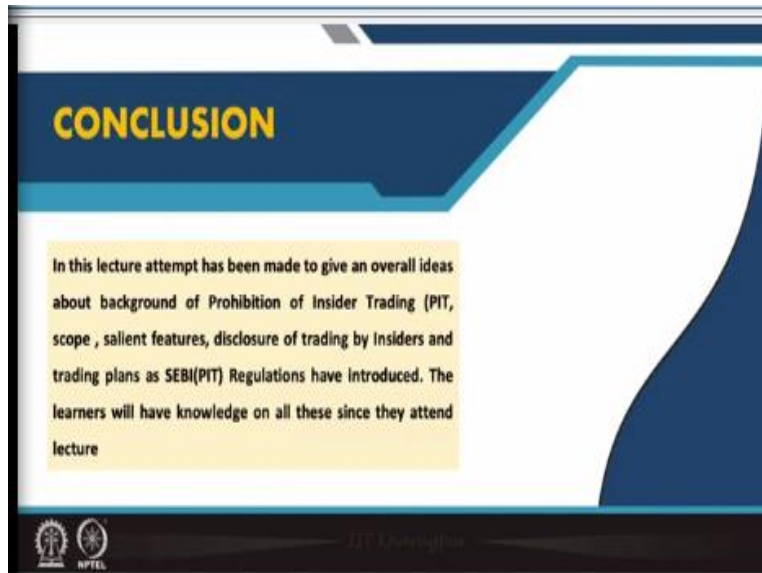
Nowhere it is informed to the stock exchange that point of time because it is not required to also, why? Because it will create a false market because only you are trying to create, you are trying to understand whether at all you will go for that acquisition or not. Now if you inform that unnecessarily share prices might go up and finally it does not happen then the share prices will go down and you will be charged with giving false information to the stock exchange, knowing fully well it will not happen you hike the prices.

So, either way it is a challenge, so you cannot give that information which is not right, which is not material, which is not something which can have really have an impact. It is more of a searching information but the searching when it starts the board of directors come to know or few of the employees of the core management comes to know. Like the finance guy, the chief financial officer, the managing director, the marketing head who will be marketing the products of that acquired company.

So, all these becomes information to them but that information is only to them but it does not go to the market, it will go to the market only after it is actually becoming something of a solid nature when it can be informed maybe it takes 6 months, maybe it takes 3 months. But during that 6 month and 3 month they are custodian of that unpublished price sensitive information.


So, it is very important that they take care of that information hold it till such time. Therefore, unpublished price sensitive information is what is the guiding factor in prohibition of insider trading regulations.

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CONCLUSION

In this lecture attempt has been made to give an overall ideas about background of Prohibition of Insider Trading (PIT, scope , salient features, disclosure of trading by Insiders and trading plans as SEBI(PIT) Regulations have introduced. The learners will have knowledge on all these since they attend lecture

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We will discuss more as we go forward, thank you.