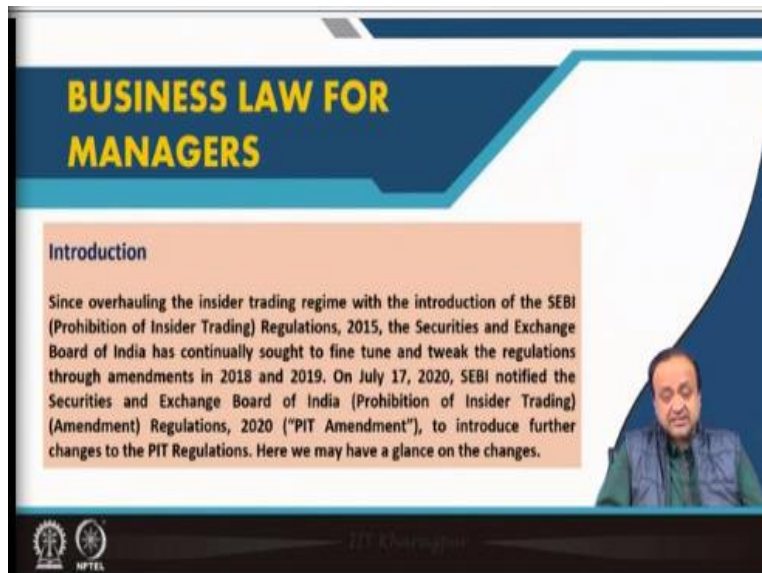


Business Law for Managers
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Module-3: PIT (Prohibition of Insider Trading)

Lecture-13
Key Changes in PIT Amendment, 2020

Good morning, we are now in lecture 13 on key changes in prohibition of insider trading amendment, 2020 which comes after 2015; initially it was for 1992, then 2015 and now 2020.

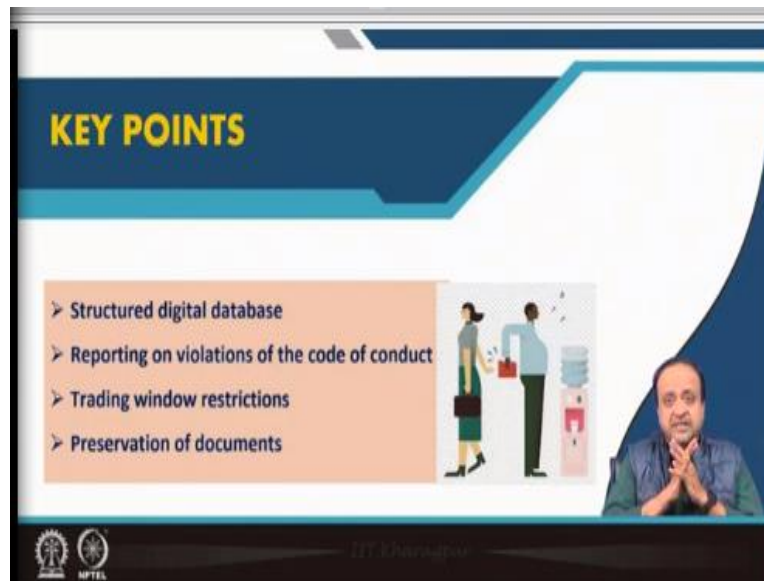
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What is the need of so many changes happening in insider trading regulations, securities and exchange board of India, has so many other regulations, why a particular regulation is repeatedly getting changed after every 5, I mean 92 then 2015 and again in 2020? There are other regulations substantial acquisition takeover regulations, CCIs all are there, then they do not require so fast changes.

Fast changes are required in SEBI insider trading regulations because what is experience now was not experienced before. More and more digital based violations, more and more violations of insider trading regulations by connected persons rather than by insiders. So, these are basically the need, these were the need to have a quick amendment of the regulations 2020.

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Some of the landmark provisions in these regulations is a structural digital database was created. This is created for all companies listed, the company does not know perhaps the company employees does not know perhaps but SEBI has a structural digital database which has been collected from the company asking for basic information including the PAN numbers to which the linking can be done of the transactions as and when recorded.

Further improvisation of the trading window restrictions have been done, very important is reporting on violations of the code of conduct. It is the duty of the stock of the companies to report any violation of the code of conduct to the stock exchange. No longer is an action to be taken by the company inside the company only, stock exchange also going to know who is that; person who has violated the code of conduct of a company and what action the company is taking on that. And preservation of documents, SEBI can ask for those documents any point of time when which requires to investigate.

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Key changes in PIT Amendment, 2020

Areas of changes

The PIT Amendment, approved by SEBI at its board meeting held on June 25, 2020, include the following key changes:

- Enhancement of the structured digital database towards seeking and storing additional details of persons sharing unpublished price sensitive information ("UPSI")
- Automation of shareholding disclosures and change in reporting authority for making disclosures of PIT violations by listed entities, market intermediaries and fiduciaries.
- Introduction for additional transactional mechanisms as an exception to trading window restrictions.

SEBI

PIT Amendment

Now this is important, enhancement of the structured digital database towards seeking and storing additional details of persons sharing unpublished by sensitive information. This was not there earlier, there was a lot of reservation in this, there was a lot of reservation even a person has been given the position of designated persons. Inside the companies many said no, I am not a designated person, I do not have privy to unpublished licensed information, why should all my details I should give it to you?

Though the answer was you are a designated person and as per designated person this information is sort by SEBI. The question then came who has made me a designated person? So, board came to the rescue and the board said we have made you the designated person. We consider you to be a designated person, designated person means person having access to unpublished price sensitive information.

A nice example can be I mean this has been a problem for many companies which are conglomerates. Now in a conglomerate there you have different companies, separate legal entities and then there is a concept of a group. The group controls not by shares but management wise, direction wise, now there is always a concept of a group CFO or a group HR head. Now they might feel that for a particular individual company how I can be a designated person?

The group CFO might still argue that I do not have information unpublished as such, it is only when the published information comes, it is the CFO that particular company who has unpublished price sensitive information. Similarly, HR might say. I am a group HR I do group directions on HR policies why I will be designated as a person having unpublished price sensitive information. And if you have made it till day it was ok you have made it, now you are asking all for my information about my digital database about my name, my employees, my spouse, my next kids and kin their pan number, their shareholding all these details why should I give?

So, they are challenging their own designation as designated persons, why because it has to be shared with SEBI and that digital database has to be created. So, lots of internal disagreements were there on this on the very concept of designated person. Finally, of course everything settle down, it takes little time to settle down, so finally it settles down and it have been accepted that all these persons are designated persons and since they are already named as designated persons.

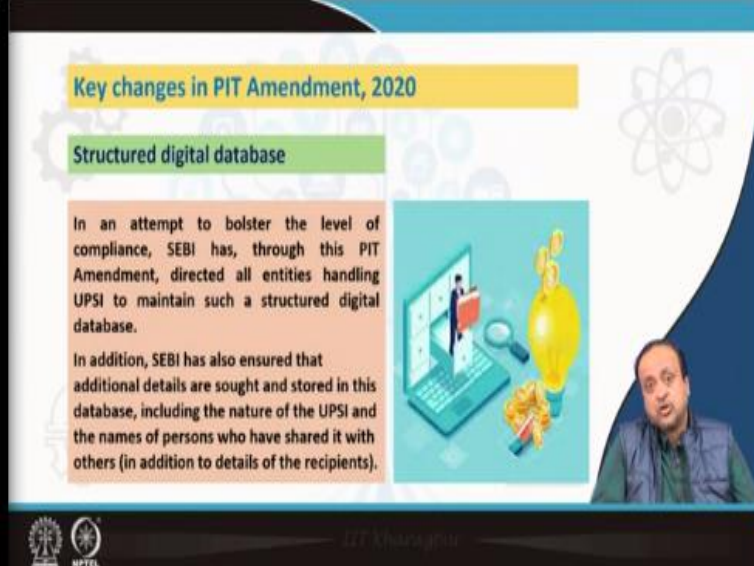
Now they cannot say they are no longer designated persons just because information has to be given about their kith and kin and their shareholdings, their relation's shareholdings, their PAN numbers etcetera. So, all this digital database gathering was a huge exercise finally to a large extent done and therefore you see lot of tracking happening through SEBI. Disclosures of PIT violations by listed entities, this also has started coming, there is an internal code of conduct for all companies if there is a violation of that the company used to take action against the employee.

But now only not the company only if your company is taking action fine, what action it is taking, what violation has happened has to be reported to the stock exchange. Stock exchange wants to know how many cases in a year happen to that company of violation. So, all this will give enough information to the company, the employees of this company are either they are not aware of or even if they are aware of why these violations are happening so much in this particular company? Just to keep track monitor put pressure to build up a robust system in particular companies.

This is called actually monitoring the company very closely, earlier SEBI was not doing this, now SEBI is doing is please disclose. Trading window restrictions were all along there, additionally certain transactions are also coming into trading window. Earlier it was only results, quarterly results, now SEBI is saying any price sensitive information, any agreement you are entering into, any contract you are entering into.

If you have information and you are going to sign an agreement, then have a trading window closer also for that. Period you decide but have a trading window closer, during which time? All the persons who are having information will not trade in the shares of the company, additional trading mechanism.

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The slide features a yellow header with the text 'Key changes in PIT Amendment, 2020'. Below it is a green box with the title 'Structured digital database'. The main content is in a light blue box with two paragraphs of text. To the right of the text is an illustration of a laptop, a magnifying glass, and a lightbulb. In the bottom right corner of the slide, there is a small video inset of a man speaking. At the bottom left, there are logos for IIT Bombay and NPTEL.

Key changes in PIT Amendment, 2020

Structured digital database

In an attempt to bolster the level of compliance, SEBI has, through this PIT Amendment, directed all entities handling UPSI to maintain such a structured digital database.

In addition, SEBI has also ensured that additional details are sought and stored in this database, including the nature of the UPSI and the names of persons who have shared it with others (in addition to details of the recipients).

This is exactly the structural database which were talked of, what are the kind of unpublished price sensitive information that normally is generated from that company that is also captured. UPSI means unpublished price sensitive information. So, a particular company these are the insiders, these are the details, these are their shareholdings, this is the trading that has happened in the last 1 month, 1-week whichever way SEBI wants to see.

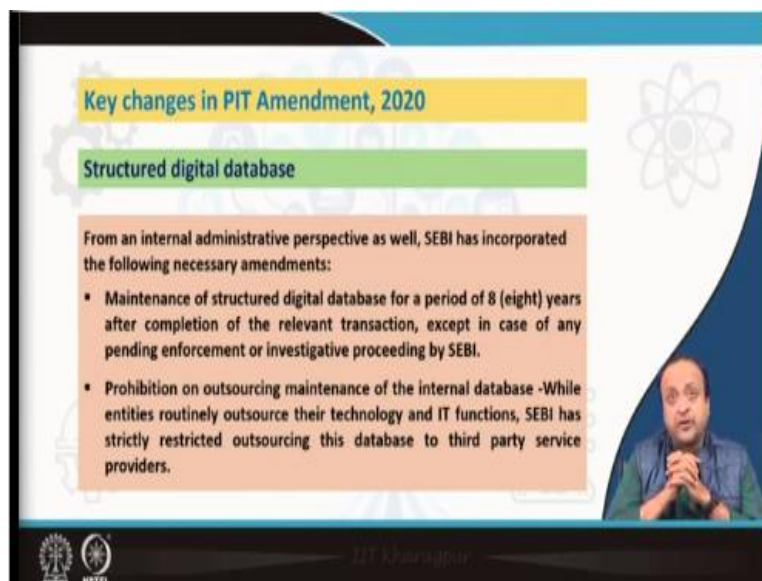
And what kind of unpublished price sensitive information they were privy to when this shareholding happened, how SEBI comes to know that it was an unpublished price sensitive information? Because after disclosure of that information it becomes public information, so prior

to that it was unpublished price sensitive information, SEBI tries to track that, that this is an information they have given about the results of the company.

So, these results before we have been prepared must be in possession of this persons, they are aware of for a period of maybe 1 month when the results were coming out, they have information for everything. During this period how much the shares were traded by them? What trading they did? Look at the kind of investigation that SEBI is doing by gathering information. Did their kid and kin of the head manufacturing buy and sell shares during the period before.

Say for example 1st March to 31st March when the results were getting prepared or any relation of the CFO or it is connected persons in the treasury department, finance department any of them bought and sold shares. Trading window closer is from 1st April but before that from 15th of March or 1st of March when results were prepared because they had information about what is going to come. So, at that point of time it was unpublished by sensitive information.

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Key changes in PIT Amendment, 2020

Structured digital database

From an internal administrative perspective as well, SEBI has incorporated the following necessary amendments:

- Maintenance of structured digital database for a period of 8 (eight) years after completion of the relevant transaction, except in case of any pending enforcement or investigative proceeding by SEBI.
- Prohibition on outsourcing maintenance of the internal database -While entities routinely outsource their technology and IT functions, SEBI has strictly restricted outsourcing this database to third party service providers.

The database has to be maintained for a period of 8 years, after completion of the relevant transaction 8 years is as per the company said also, all records are to be maintained for a period of 8 years, so SEBI has also mentioned that it will be for a period of 8 years, all documents would be had to be maintained. Unless there is any enforcement investigating proceeding started if it has already started and the investigation report is already going, it may even cross 8 years,

10 years, 12 years, really it happens. But if it happens in that case those records are to be maintained even after 8 years.

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Key changes in PIT Amendment, 2020

Reporting of violations of code of conduct

In July 2019, SEBI first prescribed the format and procedure for reporting violations of the Code of Conduct to it.

While the recent SEBI circular dated July 23, 2020 ("Circular") slightly modifies the standard format for reporting violations which was set in July 2019, the PIT Amendment and this Circular also bring forth a substantial shift in the reporting matrix.

Reporting violations format SEBI has changed, it is basically a format of reporting which SEBI has changed and we have now made it clear in the format it is mentioned. What was the nature of violation? How many shares the company particular employee was holding? How many shares the company the particular employee was holding after the particular incident? Did he increase the holding or did he reduce the holding? What was the price before, what was the price after?

Did he make any profit? Did he make any loss? When did he disclose to the company? Was the disclosure voluntary or on the enquiry of the company? So, all these parameters have to be made, finding out whether the control mechanism of the company caught him or he himself disclosed it and he disclose it when?

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Key changes in PIT Amendment, 2020

Reporting of violations of code of conduct

It is important to note that violations of code of conduct reported to SEBI were generally required to be published in the public domain.

Separately, the Circular also provides payment details for remittance of penalty imposed by entities on their designated persons violating the Code of Conduct to the Investor Protection and Education Fund administered by SEBI.

Dr. Anurag

So, there is a format of disclosure, penalties are imposed by SEBI depending upon what action the company has taken. If the company has already put a penalty, then SEBI will say if it is a just penalty if it is okay for them SEBI might say okay, fine, the penalty amount is alright. If the company has not imposed a penalty only a warning, SEBI might say no, a warning will not do, whether a loss or a profit, normally company seize the company employee has not made any profit, it is a loss, so company just gives a warning to him. SEBI says even it is a loss, it is a penalty has to be imposed, SEBI might ask the company to impose the penalty, just to debar him to do this from any further.

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Key changes in PIT Amendment, 2020

Trading Window Restrictions

The SEBI (Prohibition of Insider Trading) Amendment, 2019 introduced certain transactions to Schedule B which would be exempted from trading window restrictions. This list includes -

- Defenses to allegations of insider trading covered under Regulation 4 of the PIT Regulations (transactions carried out as a result of statutory obligations, off market trade between insiders), further public offer,
- Subscribing to a rights issue, or
- Tendering of shares in an open offer.

▪ This list under Schedule B was an indicative list and could not hence be extended to include transactions not included in the same.

Dr. Anurag

So, these are the additional when SEBI has said other than financial results when you have to put a restriction on insider trading and have a trading window closer. Now introduce certain restrictions which would be exempted from trading window this list includes, differences to allegations of insider trading covered under regulation 4 of PIT regulations out of statutory obligation. Subscribing to a rights issue; tendering of shares in an open offer.

Now subscribing to a rights issue will not come under trading window restrictions because rights issue is something which is given to the shareholders as a rights entitlement. So, when you are making an issue of shares to the right shareholders and they are subscribing to the right shares. So, it is not a case of any trading window restrictions, it will not come under trading window because it is a rightful right of a shareholder to subscribe to the rights issue.

And it is again determined at a price through a process described by SEBI only SEBI has a mechanism for issue of right shares. The price is we determine by the merchant banker in accordance with the formula. So, that formula has to be followed, for that if somebody is subscribing to a rights issue it will not come into trading restrictions. Tendering of shares in an open offer, when does the open offer happen?

When somebody acquires shares more than 25% or more than 75% in a company before acquiring, he has to give an open offer to all the shareholders. So, this when the tendering of shares in an open offer happens that also there is no trading restrictions for that. So, these are the only restrictions which are given but restrictions like acquisition of shares, restrictions on expansion of the company, restrictions during amalgamation or when QIP issues are going to happen, qualifying institutional placements. All those times the trading window closures will take place and it will be informed the trading window will be closed from this to this.

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Key changes in PIT Amendment, 2020

Trading Window Restrictions

The PIT Amendment has created room for SEBI to consider and recognize additional categories of transactions/ mechanism as an exception to the closure of trading window related restrictions.

Following the PIT Amendment, and moving away from the SEBI board meeting takeaways, SEBI recently issued another circular on July 23, 2020, through which it has now permitted offer for sale and rights entitlement transactions to be carried out while the trading window is closed.

The amendment has further given power to SEBI to bring in additional categories of transactions mechanism and on exception to the closure of trading window restrictions; some additional power has been given. Overriding power has been given to include but also power has been given to exclude certain trading window related restrictions which are statutorily an employee is required to do, ESOP for example.

A company is giving ESOP to its shareholders; employee stock options scheme, any employee buying those shares does not fall under the prohibition of insider trading regulations, there is no trading restrictions on that. Accepting the fact when he stops are given to you in ESOP itself it is stated that you have to have a lock-in period of 1 year, 2 years depending on what is the nature of ESOP. Some companies have a 1-year lock-in period, some companies have a 3 years lock-in period that is it, no further prohibition can be there from SEBI side. So, statutorily certain restrictions are given separately, rights issues, open offer, ESOP which are permitted.

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Key changes in PIT Amendment, 2020

Preservation of documents

Regulation 8, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015: "Preservation of documents –

The listed entity shall have a policy for preservation of documents, approved by its board of directors, classifying in at least two categories as follows-

(a) documents whose preservation shall be permanent in nature;

(b) documents with preservation period of not less than eight years after completion of the relevant transactions:

Provided that the listed entity may keep documents specified in clauses (a) and (b) in electronic mode."

Preservation of documents is very important because later on it happens the documents are not there; SEBI might sue the company for not preserving the document. It is a very easy way of trying to escape, documents are not there, beyond 3 years we do not keep documents that will not do, for 8 years you have to preserve the documents and investigation starts it can be a number of years once investigation starts within 8 years, then that those records are to be kept permanently.

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SEBI as regards this trading window is concerned and restrictions are concerned is still evolving; it is not something basically which has come to any kind of a conclusion like that. SEBI has kept it open and also inviting suggestions, there is a forum of SEBI which invites suggestions from investors particularly the retail investors, not only the institutional investors, retail investors what

kind of information flow is preventing them to have information, further information of the company.

Is there anything which is preventing them? What further information they want from the company? And if there are instances where they find that the large investors are privy to more information than the retail investors, SEBI is reaching out to the retail investors which has not happened in the past. It was more concerned with the disclosure requirements, the prohibition of insider trading by the employees of the company and designated persons.

And to some extent; information flow to the large investors, the institutional investors, the foreign portfolio investors but what about the retail investors, the investors who really need the liquidity in the market. Many times, their information flow to them is restricted; they get a neglected attitude from the corporates. Well, these are small investors, they do not may add up too much on the market demand and they cannot increase the market cap neither they can reduce the market cap.

So, information flow to them does not become the primary target, all the institutional investors presentations, all that the company does is only to the big investors. The small investors hardly get an opportunity to meet the MD and the CEO on the investor presentations. They look for only the results that come out in every quarter, how much they understand from the results is a difficult thing.

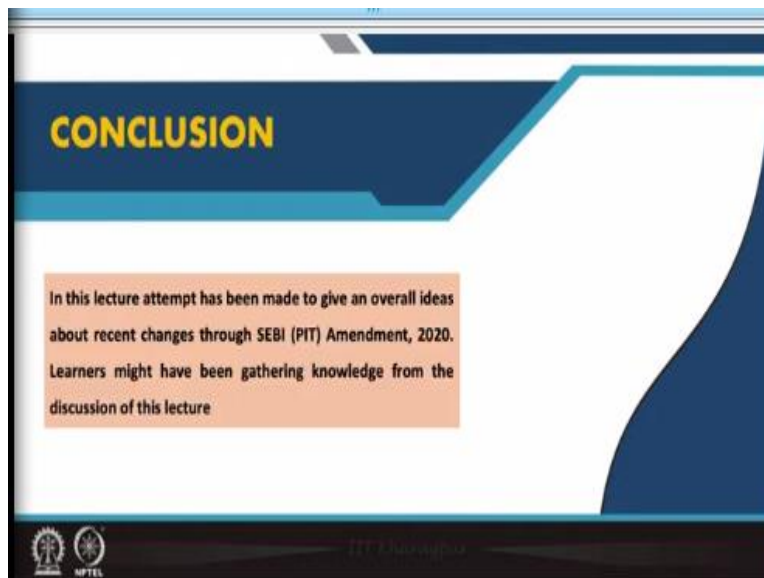
Because financial results understanding, itself is very difficult, they depend on the annual report which comes in once in a year and they go through the company website. Again, going through the company website and understanding the company is may be difficult from investors who are not financially that literate or aware of. So, what is this large number of institutional I mean retail investors how do we address their need for information?

So, SEBI is looking into that and has already started approaching the retail investors to inform what kind of information flow from the company would help them to take an informed decision about investment in the company. So, that is what is going to come in days to come when maybe

a portal may be opened up by SEBI asking retail investors. It is also a fact some of the retail investors are gradually becoming mid level investors, they are no longer 100, 200 shares may hold even 1000, 10000, 15000 shares. So, it is not a question of the 100 and 200 shares, so those 15000, 20000 shares obviously whole shareholders obviously would require some information flow from the organization.

Maybe a retail investor meet we may see in coming days, where the retail investors maybe 100 or 200 of them are met. And company gives information, shares information which are there in the public domain but in a more explainable manner to them. Understand what their queries on the company get their views. So, that may be what may be the order of the day coming from SEBI. These are some of the references that I have taken but mostly again I repeat from my experience in this field.

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