

## FAQs ON 'RESTRICTIONS ON INSIDER TRADING IN INDIA'



'Insider trading' refers to trading in the securities of a listed company by persons who have access to information that is not available to the general public on a non-discriminatory basis. Insider trading in India is regulated by the Securities and Exchange Board of India (**SEBI**) and governed under the provisions of the SEBI (Prohibition of Insider Trading) Regulations, 2015 (**PIT Regulations**). In this primer, we have answered a few frequently asked questions on restrictions under insider trading in India.

## A. GENERAL

### 1. What is trading?

Trading is any act of subscribing, buying, selling, and/or dealing in securities or agreeing to do any of the foregoing acts. The term 'trading' has been widely defined to include any 'dealing' in securities, pursuant to which actions such as pledging, gifting, and transmission of securities also fall within the definition of 'trading'.

### 2. What are the kinds of securities covered under the purview of the PIT Regulations?

- 2.1. Securities include:(a) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities, of any incorporated company, pooled investment vehicle or other body corporate; (b) derivatives; (c) units or other such instruments issued by a collective investment scheme registered under the SEBI Act, 1992 (**SEBI Act**); (d) security receipts under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002; (e) units or other instrument issued by any pooled investment vehicle; (f) certificate or instruments issued by a special purpose distinct entity which possesses any debt or receivable; (g) government securities; and (h) such other instruments as may be declared by the Central Government to be securities.

2.2. It must be noted that the PIT Regulations create a specific carve-out in the definition of 'securities', pursuant to which units of a mutual fund do not fall within the ambit of the PIT Regulations.

2.3. Trading in American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) by employees of listed companies is also covered under the PIT Regulations.

### 3. **Whether dealing in debt securities is within the ambit of the PIT Regulations?**

Yes. The definition of securities provided under response 2 above includes debt securities. Accordingly dealing in debt securities will be covered under the PIT Regulations.

### 4. **Are unlisted securities included within the ambit of the PIT Regulations?**

4.1. Yes. Certain provisions of the PIT Regulations, such as the provisions regulating communication of Unpublished Price Sensitive Information (**UPSI**) also apply to unlisted companies whose securities are proposed to be listed on a recognized stock exchange.

4.2. Any unlisted company that has filed offer documents with SEBI, a stock exchange, or the registrar of companies in connection with listing on a stock exchange, or an unlisted company getting listed pursuant to a merger or amalgamation is a company that is 'proposed to be listed'. The restrictions under the PIT Regulations will also be applicable to the securities of such unlisted companies.

4.3. A company may be construed to be a company that is 'proposed to be listed' from the date of the board resolution, the appointment of a merchant banker, or the filing of a red herring prospectus in relation to the proposed listing.

### 5. **What is UPSI?**

5.1. Any information related to a company, or its securities which is not generally available to the public on a non-discriminatory basis, and which information is likely to materially affect the price of the securities upon being made available to the public, is considered to be UPSI. UPSI is an inclusive term which includes financial information of the company, information related to the changes in the capital structure or the key managerial personnel of the company, or any information related to mergers, demergers or similar corporate restructuring, or expansion of business of the company. Any information published on the website of the stock exchange is construed to be generally available information.

5.2. Further, the determination of whether any information materially affects the price of the securities of the concerned company is a subjective determination and shall vary on a case to case basis. Additionally, if the publicly available information is speculative in nature, then the same shall not be considered to be generally available information.

### 6. **Who is an insider?**

Any person who is a connected person, or has access to UPSI, regardless of the manner in which the person comes in possession of the UPSI will be an insider.

### 7. **Who is a connected person referred to in the definition of Insider?**

7.1. A 'connected person' means any person who has been directly or indirectly associated with a company at any time within the 6 (six) months preceding the concerned regulated action or omission. The association of a connected person with the company may be by way of: (a) frequent communications with the officers of the company; (b) a contractual, fiduciary or an employment relationship with the company; or (c) any other form of professional or business relationship which is reasonably expected to allow such a person to access any UPSI in relation to the company. The nature of the association between the person and the listed company may be temporary or permanent in nature.

7.2. Non-executive directors not involved in the day-to-day affairs of the company will not generally be treated as connected person.

## 8. Who are persons deemed to be connected persons?

8.1. The definition of a 'connected person' is wide and inclusive, and certain categories of persons are deemed to be connected persons unless the contrary is established. Persons deemed to be connected persons include:

8.1.1. immediate relatives of connected persons, where an immediate relative is the spouse, parent, sibling, or child of such a person, or of the spouse, who are financially dependent on the connected person, or who consults the connected person while taking decisions related to trading in securities;

8.1.2. holding, associate or subsidiary companies;

8.1.3. intermediaries registered under the SEBI Act, or the employees and/or directors thereof;

8.1.4. a banker of the company; and

8.1.5. other entities as identified under the PIT Regulations.

8.2. While investigating whether an entity is a connected person, SEBI has even looked at connections and interactions between the relevant persons on social media.

8.3. Further, a spouse is deemed to be a connected person unless it can be proved that he/she is financially independent and does not consult the connected person in the investment decisions being taken by such spouse.





## B. RESTRICTIONS ON COMMUNICATION

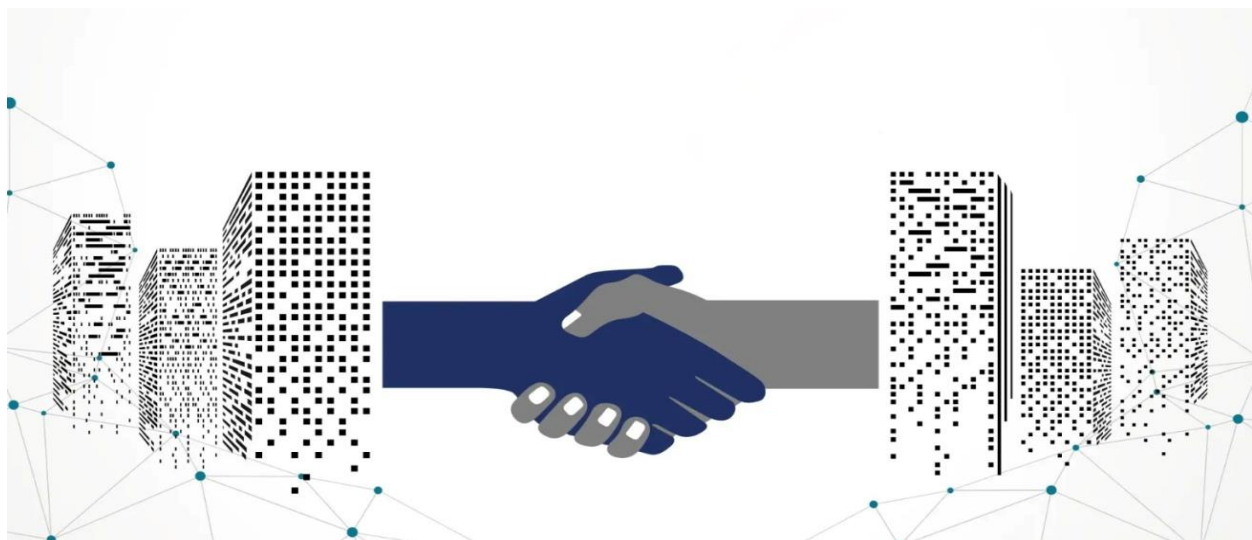
9. **What are the restrictions laid down by the PIT Regulations for communication of UPSI?**
  - 9.1. An insider is not permitted to communicate any UPSI related to a company or securities that are listed or proposed to be listed, to any other person, even if such other person is an insider.
  - 9.2. It must be noted that the PIT Regulations also imposes obligations on persons other than insiders to not similarly procure or induce an insider to communicate any UPSI.
10. **Under what circumstances can UPSI be disclosed to non-insider entities without violating PIT Regulations?**
  - 10.1. Insiders may communicate UPSI if the communication is in furtherance of legitimate purposes (*discussed in more detail in question 11 below*). UPSI may also be communicated if the sharing of UPSI is necessary for the performance of the duties, or for the discharge of legal obligations of the insider.
  - 10.2. Similarly, persons other than insiders may also procure or induce the communication of UPSI in cases where the same is in furtherance of legitimate purposes, the performance of duties or discharge of their legal obligations.
  - 10.3. The PIT Regulations also prescribe certain other instances where UPSI may be communicated to non-insider entities and the same have been discussed under question 12 below.

**11. What are legitimate purposes for which UPSI may be shared?**

- 11.1. As mentioned under response 10 above, UPSI may be communicated in furtherance of legitimate purposes. The board of directors of every listed company is required to formulate a policy to determine the 'legitimate purposes' for which UPSI may be shared. 'Legitimate purposes' may include the sharing of UPSI in the ordinary course of business with other partners, customers, suppliers, or professionals.
- 11.2. A person receiving UPSI for 'legitimate purposes' is also considered to be an insider. Such persons are consequently also required to maintain the confidentiality of such UPSI as per the PIT Regulations. Such persons are required to enter into confidentiality agreements in relation to such non-disclosure of UPSI.

**12. Can any information related to a listed company be shared with entities proposing to enter into a scheme of merger or amalgamation with the listed company?**

- 12.1. Yes. The PIT Regulations permit the sharing of any information including UPSI, to other entities for the purposes of a transaction where the sharing of UPSI is necessary in the opinion of the board of directors of the listed company. UPSI may be shared with other entities in connection with the following kinds of transactions:
- 12.1.1. a transaction that entails an obligation to make an open offer under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011; and
- 12.1.2. a transaction that does not entail an obligation to make an open offer, provided the relevant UPSI is made generally available at least 2 (two) trading days prior to the completion of the proposed transaction.
- 12.2. Further, prior to sharing such information, the board of directors of the listed company must ensure that appropriate confidentiality and non-disclosure agreements are entered into with the entities receiving the UPSI, such that the entities receiving the UPSI are under similar obligations to keep such information confidential and to not trade in the securities when in possession of the UPSI.





**C. RESTRICTIONS ON TRADING**

**13. What are the restrictions on insiders for trading in securities when in possession of UPSI?**

An insider is not permitted to trade in any securities that are listed or proposed to be listed when the insider is in possession of UPSI. Any trades executed by a person having UPSI, are presumed to have been motivated by the knowledge and awareness of such UPSI.

**14. What are the instances when trading in securities is permitted by insiders having possession of UPSI?**

14.1. Trading in securities by insiders when the insider is in possession of UPSI may be permitted under the following circumstances:

14.1.1. when the trading is an off-market inter-se transfer or a transfer through the block deal window mechanism between insiders who are in possession of the same UPSI;

14.1.2. when the trading is done pursuant to a statutory or regulatory obligation;

14.1.3. when the trading is undertaken pursuant to the exercise of stock options where the exercise price is pre-determined as per applicable laws;

14.1.4. when the trading is between non-individual insiders, and the individuals in possession of UPSI are different from persons taking decisions on behalf of the non-individual insider, and if adequate measures are in place to ensure compliance with the PIT Regulations; and

14.1.5. when the trading is pursuant to a valid trading plan under the PIT Regulations.

**15. Whether insiders can trade through discretionary portfolio management service providers, when in possession of UPSI?**

No. As per an informal guidance of SEBI, if an insider has any UPSI in relation to a particular company, such insider cannot trade in the securities of such a company, even if the trading is done through a discretionary portfolio management service provider, where such insider does not have control over the trading undertaken by the discretionary portfolio manager. Such trades are deemed to be motivated by the knowledge of the UPSI in possession of the insider.

**D. DISCLOSURE REQUIREMENTS**

16. **What are the thresholds for disclosures to be made by certain identified individuals, including the promoters or promoter group, under the PIT Regulations?**
- 16.1. Disclosure requirements have been prescribed for identified individuals who are likely to be in possession of UPSI. The initial, and continued disclosures to be made by such individuals are:
- 16.1.1. Every person appointed as a key managerial personnel, or a director, or upon the inclusion of such person as a promoter, or in the promoter group, is required to disclose his holding of securities within 7(seven) days of such appointment or inclusion.
- 16.1.2. Further, every promoter, member of the promoter group, designated persons, and director of a company must disclose any acquisition or disposal of securities where the value of the securities traded in any calendar quarter exceeds INR 1,000,000 (Indian Rupees One Million) and these disclosures are to be made within 2 (two) trading days of such acquisition or disposal. The market value of the securities as per date of transfer of securities will be considered while determining whether the above thresholds are breached.
- 16.1.3. Within 2 (two) trading days of receiving any information regarding any transaction as per paragraph 16.1.2. above, the company must notify the stock exchange of such transactions.
- 16.2. The disclosures must be made in the formats as prescribed by SEBI vide its circulars dated 16 September 2015, and 9 February 2021.
- 16.3. Additionally, listed companies may also require other connected persons or classes of connected persons to make disclosures of holdings and trading in the company's securities as it may deem necessary to monitor compliance with the PIT Regulations.
- 16.4. The company receiving the disclosures must maintain such disclosures for a minimum period of 5(five) years.



**17. What are system-driven disclosures and what are the compliances for listed companies in relation to system-driven disclosures?**

- 17.1. By way of a number of circulars and amendments to the PIT Regulations, SEBI has implemented a mechanism of system-driven disclosures pursuant to which the process of providing continual disclosures is sought to be automated.
- 17.2. Under the automated mechanism of system-driven disclosures, listed companies must intimate the details of the demat accounts and the Permanent Account Number (PAN) of the promoters, promoter group entities, and designated persons to a designated depository. Once a listed company has shared the above details with the designated depository, the requirement of continual disclosures as provided under paragraphs 16.1.2. and 16.1.3. will no longer be applicable to such listed companies.

**18. Are disclosure requirements under PIT Regulations also applicable to the immediate relatives of the concerned individuals?**

If a disclosure is required to be made under the PIT Regulations by any person, a similar requirement for disclosures is also placed on the immediate relatives of such persons.

### E. COMPLIANCE REQUIREMENTS

**19. What are the compliance obligations for companies whose securities are listed on a stock exchange, and other entities that deal with UPSI?**

- 19.1. Companies whose securities are listed on a stock exchange, and other entities such as market intermediaries and entities required to deal with UPSI (**fiduciaries**) are required to comply with a few regulatory requirements. Fiduciaries includes professional firms such as auditors, law firms, registered valuers.
- 19.2. The compliance requirements for the above entities have been discussed hereinafter:
- 19.2.1. Formulating a Code of Fair Disclosure

The board of directors of every listed company is required to maintain a code of practices and procedure for fair disclosure of UPSI. The code of fair disclosure should include the principles of fair disclosure as provided under schedule A of the PIT Regulations. The code of fair disclosure must be maintained on the website of the listed company. Additionally, the code of fair disclosure, including any amendments thereto, must also be intimated to the stock exchanges where the securities of the company are listed.

19.2.2. Formulating a Code of Conduct

Listed companies, market intermediaries and fiduciaries must formulate a code of conduct to regulate, monitor and report trading by designated persons, so as to ensure compliance with the PIT Regulations. The code of conduct contains details of the process for obtaining prior approval for trades, mechanisms for handling of UPSI only on a need to know basis, trading restrictions on contra trades, reporting of trades to the compliance officer, and reporting by the compliance officer to the management of the concerned entity.

- 19.2.3. Appointing a compliance officer (*discussed in more detail in question 20 below*)
- 19.2.4. Identifying designated persons (*discussed in more detail in questions 21 and 22 below*)
- 19.2.5. Maintaining a structured digital database (*discussed in more detail in question 23 below*)





**20. Who may be appointed as a compliance officer and what are their duties?**

- 20.1. Any senior officer of the concerned entity may be appointed as a compliance officer. Such a senior officer must be financially literate and should be capable of appreciating requirements for legal and regulatory compliance.
- 20.2. Every entity which is required to formulate a code of conduct, is also required to appoint a compliance officer. The compliance officer is responsible for administering and monitoring compliance of the designated persons and other employees of the entity with the code of conduct. The compliance officer also plays a key role in the maintenance of records, approval of trading plans, and providing timely intimations to the stock exchanges.

**21. Who are designated persons?**

- 21.1. Designated persons are individuals who may have access to UPSI due to their role, function, seniority, and professional designation in the concerned entity.
- 21.2. Designated persons include promoters of the relevant entity, the chief executive officer (CEO), employees up to 2 (two) levels below the CEO, and other staff who have access to UPSI.

**22. Which persons will be said to have a 'material financial relationship' with a designated person?**

A person will have a material financial relationship with a designated person, if such person has received any kind of payment, such as a loan or a gift, from the designated person, which payment is more than 25% (twenty five percent) of the annual income of the designated person, and such transfer has occurred in the last 12 (twelve) months. If the transfer is at an arm's length basis, it will not result in the establishment of a 'material financial relationship' between the person and the designated person.

**23. What is a structured digital database to be maintained under the PIT Regulations?**

- 23.1. Every entity required to handle UPSI is required to maintain a structured digital database for storing the following information:

23.1.1. nature of the UPSI handled by the entity;

- 23.1.2. names of the persons from whom the UPSI is received;
- 23.1.3. names of the person with whom the UPSI is shared, along with a personal identifier.
- 23.2. The details under the structured digital database have to be maintained for a minimum period of 8 (eight) years, or for such other time as may be necessary for the completion of any investigation or enforcement proceedings that may have been initiated. Entities required to maintain a structured digital database, cannot outsource its maintenance to third parties.

#### 24. **What are the penalties for Insider Trading?**

- 24.1. As per the SEBI Act, any insider who, on his own or on behalf of any person deals in securities of a listed company on the basis of UPSI, or communicates the UPSI to any person or procures any other person to deal in any securities on the basis of UPSI, is liable to pay a penalty not less than INR 1,000,000 (Indian Rupees One Million) but which may extend to INR 250,000,000 (Indian Rupees Two Hundred and Fifty Million) or 3 (three) times the amount of profits made out of the purported acts of insider trading, whichever is higher.
- 24.2. Further, entities required to formulate the codes of fair disclosure and code of conduct may also lay down any sanctions, disciplinary actions, or provisions for suspension for contravention of the provisions of the PIT Regulations. The amounts collected by the relevant entity pursuant to such sanctions must be deposited with the Investor Education and Protection Fund, as per SEBI's circular dated 23 July 2020.

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