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Grey areas in insider trading regulations needs clarity: Experts

Chennai, May 17 (IANS): The Indian securities market regulator has to clarify certain grey areas such as whether the employee stock options (ESOP) is also covered by its new insider trading regulations that came into force on May 15, say legal and industry experts.

Corporate compliance officials hold that the new regulations have imposed some additional risks on them as a large community of outsiders including journalists, vendors, bankers and others have been included under the definition of the term insider.

"The old insider trading regulations expressly kept out ESOPs whereas the new regulations do not as per interpretations. Normally ESOP schemes are well-defined and it is an option to buy," S.Swaminathan, chief financial officer, Intellect Design Arena Ltd, told IANS.

"It should also be said any step towards improvement of corporate governance is welcome," he added.

Pratibha Jain, partner and head, regulatory practice, Nishith Desai Associates, told IANS that the Securities and Exchange Board of India has overhauled the insider trading regulations "with a view to provide a level playing field in the securities market and also to safeguard investor interest".

She also agreed that the ESOP issue is a grey area that SEBI has to address. According to her colleague Tanya Pahwa, the 1992 insider trading regulations had kept out ESOPs.

"Under the new regulations, the scope of the term 'insider' or a 'connected person' has been widened.

"Therefore, any person, whether or not related to the company, may come within the purview of the regulations if he is expected to have access or possess unpublished price sensitive information. Applicability of the regulations shall extend to unpublished price sensitive information in relation to a company as well as securities listed or proposed to be listed on a stock exchange," Jain said.

The new regulations - Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 - define an insider as any connected person or any person in possession of or have access to unpublished price sensitive information.

A connected person includes any person who is or has during the six months prior to the concerned act been associated with the company, including through frequent communication with its officers or as a director, officer, vendor and others with an access to unpublished price sensitive information.

The term connected persons include immediate relatives; holding/subsidiary or associate company; mutual fund; stock exchange or clearing house official; banker and others.

According to Intellect Design Arena's Swaminathan, a large third-party community has been included as insider and it is a challenge for listed companies to get disclosure compliance from them.

"Perhaps a monetary threshold level of dealing in securities should be stipulated by SEBI," he said.

The regulations will also extend to unpublished price sensitive information in relation to a company as well as securities listed or proposed to be listed on a stock exchange, Jain said.

"For the purpose of legitimate business transactions, access to unpublished price sensitive information, for instance, of due diligence, with appropriate safeguards has been explicitly provided for which shall avert the risk of any regulatory scrutiny in relation to such transactions," she said.

The board of directors of every listed company and market intermediary have to draw up a code of conduct to regulate, monitor and report trading by its employees and other connected persons in accordance with the regulations, she added.

Jain said the regulations further provide every other person who is required to handle unpublished price sensitive information in the course of business operations such as auditors, accountancy firms, law firms, analysts, consultants, other capital market participants and others are also required to draw up such a code of conduct.

Therefore, even entities that normally operate outside the capital market may be required to formulate such a code depending on their exposure to unpublished price sensitive information.

Also, every such person formulating a code of conduct is required to identify and designate a compliance officer to administer the same, Jain remarked.

"Trading in the security of the company is not permitted when trading window is closed on account of a unpublished price sensitive information. Further, pre-clearance is required for a trade exceeding Rs.10 lakh, even if the trading window is not closed."

The trading window is supposed to close for a company upon certain events like declaration of financial results and opened upon cooling-off period of 48 hour of relevant information becoming generally available.

The management, in addition to the penalty by the regulator, can also initiate disciplinary action against violators with steps that can include wage freeze, suspension, ineligibility for future participation in stock options and withholding of promotions.

"While the new regulations widen the ambit, a lot more investment in monitoring and surveillance needs to be made. Even globally it is not easy to catch insider trading. And which is why exemplary punishment needs to be handed out which would act as a strong deterrent," Pranav Haldea, managing director, Prime Database, told IANS.

Jain however noted that SEBI has an investigation arm responsible for looking into any alleged wrongdoings.

"Based on recent amendments to the SEBI Act, they also have power of search and seizure. SEBI investigation for insider trading is typically based on a tip or one of exchanges reporting unusual activity in trading of a stock," she said.