Anomalies in PIT Regulations intentional or un-intentional!

Study of Interpretation of statues tells us that unless literal rule is leading to some absurdity, that is the only rule which should be applied while interpreting any provisions. Judiciaries also do not apply any other interpretation principle unless it is really necessary. However, while interpreting provisions of SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations), from time and again purposive interpretation plays bigger role than literal rule. Further, some provisions of PIT Regulations appear to have been left open intentionally; whereas at some occasions, more specific words could have served the cause better.

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INTRODUCTION

Objective of SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations) has been clearly to protect investors interest. PIT Regulations attempts to avoid impact on price discovery mechanism and to maintain equality of access to price sensitive information. For this, it is necessary to ensure that no insider takes leeway under provisions of PIT Regulations itself. Therefore, PIT Regulations are more principle based and less rule based. Industry and market players expect that some transactions should be excluded from gamut of PIT Regulations. However, PIT Regulations appear to have been worded in such a way that, SEBI should be able to do very effective enforcement. At many places, we find open-ended words in PIT Regulations. Many may be intentional however some provisions may need correction. We are discussing some anomalies in PIT Regulations - some anomalies appear intentional where some anomalies appear to be not meeting the objective.

Whether gift of securities are regulated under PIT Regulations?

Sodhi Committee[1] says in order to charge someone with violation of PIT Regulations consideration is necessary in trade transaction; however, there is no specific mention about necessity of consideration in PIT Regulations. Literal reading of definition of term 'trading' tells us that, it is an inclusive definition and it also covers word 'dealing' which is much wider and there may be consideration or there may not be consideration involved in the transaction[2]. That means if an Insider gifts some securities to his near one while the window is closed or while in possession of Unpublished Price Sensitive Information (UPSI), will it amount to trade and thereby will amount to violation of regulation 4(1) of PIT Regulations?

However, even if donor or donee has some UPSI, a gift by insider (donor) to his relative (donee) will not impact price discovery and thereby apparently it may not impact public investor. Sodhi Committee's view was in line with these thoughts. This thought is substantiated when we read SEBI Adjudication order in the matter of Kavveri Telecom Infrastructure Ltd[3], where there was a transfer of shares by way of gift from husband to wife during the period when they were in possession of UPSI. SEBI had held that these transfers cannot be termed as 'trading' as they are off-market transfers for no consideration and, therefore, do not fall under the category of 'buy or sell transaction'. Transferee had subsequently sold/ pledged the shares. It was also held that the allegation of entering into opposite transactions within a duration of six months, has not been established.

The question which arises is, if gift is to be excluded from the term trade, why that has not been specifically mentioned in definition of 'trading'? Further, there are 6 transactions mentioned under proviso to regulation 4(1) which are categorically worded as 'defence' and not as 'exemption'. Gift does not form part of these defences either!!! Close reading of the provisions of PIT Regulations and above-mentioned SEBI Adjudication Order, it appears that SEBI has not given blanket exemption to gift from the term 'Trading' because otherwise this may be misused by some insiders. Eg: When trading window is closed for Designated Persons, he may gift it to a person who is not falling under immediate relative category and that person may sell shares further! This will be clear circumvention of PIT Regulations and therefore, gift is not excluded from the term 'Trading'.

It appears that whether 'consideration' is necessary for term 'trading' or not is not clarified so that no insider misuse it!

[1]Para 35 which says "Trading" in the ordinary English meaning of the term would entail an act of getting something in return for something else i.e. entailing an element of consideration changing hands and Para 38 which says, "when one trades securities or interest in securities for something else, one would be trading in the security for consideration."

[2]"Trading" is defined in Regulation 2(1)(l) as "trading" means and includes subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities, and "trade" shall be construed accordingly

[3]SEBI Adjudication Order No. KS/VC/2020-21/ 8459-8463 dated 31 July 2020 in the matter of Kavveri Telecom Infrastructure Ltd

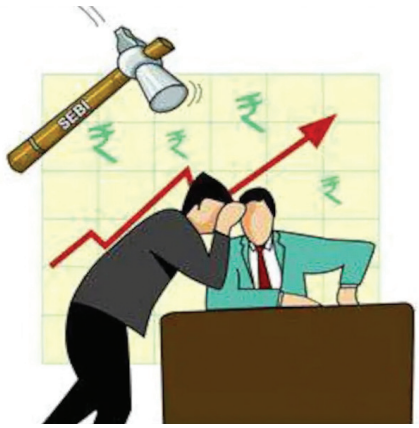
Whether Promoter Group entities are required to be included in the list of Designated Persons?

In SEBI (Prohibition of Insider Trading) Regulations,1992, promoters and promoter group entities were required to give disclosures about high value trades under erstwhile regulation 13. When these regulations got replaced with PIT Regulations 2015, promoter group was not specifically covered under regulation 6 and 7 of PIT Regulations. In fact trades of immediate relatives were required to be disclosed but the term 'promoter group' was not specifically covered under regulation 6 or under regulation 7. As a result of this, entities falling under promoter group definition, other than immediate relatives, were not making disclosure under regulation 7. For example group companies of promoter Companies, were neither promoters nor immediate relatives, neither directors nor KMPs, and therefore were not required to make disclosure with respect to high value trades under PIT Regulations! This got corrected on 21 January 2019 when regulation 7(1) and 7(2) both got amended and the term 'members of promoter group' was added in both the provisions, thereby making mandatory upon promoter group entities to make initial disclosure and continual disclosures!

Interestingly the term 'designated person' is explained under regulation 9(4) of PIT Regulations. Like other terms, SEBI has used two fold definition here, i.e. (1) it explains the concept as to who should fall under the term 'designated persons', i.e., who in opinion of the board of directors are discharging some function or role in the organisation which gives them access to UPSI, and (2) some category of individuals or entities who have to be covered under Designated Persons list (deeming fiction). The term 'promoter' is specifically covered under this list of deeming fiction, however 'promoter group' has not be covered. As a result of this, the board of directors has to mandatorily cover promoters in Designated Persons list, however promoter group entities could be covered under Designated Persons list only if they have any role or function in the organisation which gives them access to UPSI and not otherwise!!!

When PIT Regulations were amended on 21 January 2019, the term 'promoter group' was inserted under regulation 7(1) and 7(2), why it was not inserted under regulation 9(4) which was already notified at that time, though regulation 9(4) had not yet become effective then (it became effective from 1 April 2019)? Was it an omission or thoughtful decision? SEBI Agenda notes and Minutes for its meeting dated 12 December 2018 when it considered the said amendment is not giving us clue (it is silent). But it appears to be thoughtful as not every promoter group entity may have any function or role in the organisation which gives them access to UPSI, therefore the term 'Promoter Group' was not added in regulation 9(4).

Difference between regulation 7 and regulation 9(4) is that while disclosure requirement under regulation 7 is on promoter/ promoter group, whereas the responsibility to identify list of Designated Persons and collating relevant data from them is on the Company. Incidentally when SEBI decided to take the System Driven Disclosure under same regulations 7(2) to next level (vide its circular date 9 September 2020), it mandated all the listed companies to



provide details of Promoter Group entities with Designated Depositories!!! Now, updating list of promote group entities along with list of Designate Persons is on the Company. As a result of that, whether SEBI expects companies to cover all promoter group entities under list of Designated Persons or not is an ambiguity!

Whether transactions related to pledge of securities needs to be disclosed under regulation 7(2)?

Sodhi Committee had strongly recommended in 2015 that transactions like pledge should not be regulated under PIT Regulations. Sodhi Committee had acknowledged that there are chances that if pledge is excluded from the gamut of PIT Regulations it can be mis-used. However, it had suggested that it can be dealt with separately under Section 12A of SEBI Act, 1992. SEBI felt it appropriate to retain pledge as one mode of dealing and therefore should be considered as trading and thereby needs to be regulated under PIT Regulations. All across PIT regulations, the words 'trade', 'trading' have been used while regulation 7 (2) uses the word 'acquisition and disposal' and not 'trading'!! And therefore question arises as to whether details of pledge are required to be disclosed under regulation 7(2) or not!

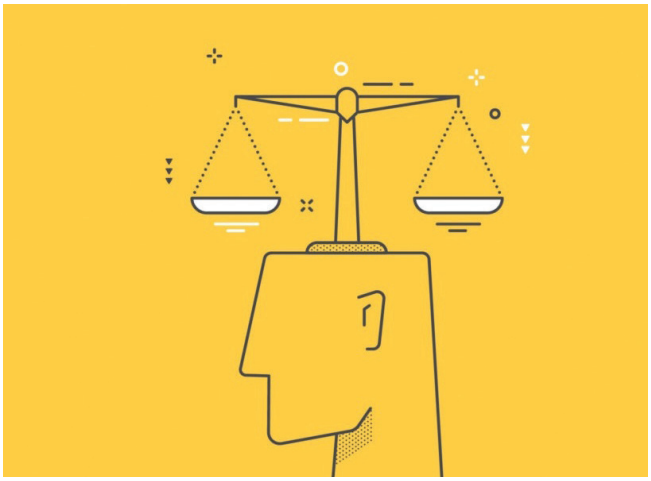
Supreme Court had held in Oriental Insurance case[4] that if different words of different import are used in the same statute, there is a presumption that they are not used in the same sense. And therefore there is a view that only acquisition or disposal of securities would require disclosure under regulation 7(2) and other transactions which are not falling under acquisition or disposal but covered under trading eg. pledge, does not require disclosure under regulation 7(2).

In Tata Chemicals case[5], the Supreme Court had held that it is cardinal principle of interpretation of Statutes that the words of a Statute must be understood in their natural, ordinary or popular sense and construed according to their grammatical meaning unless such construction leads to some absurdity or unless there is something in the context or in the object of the Statute to the contrary.

One cannot go to find the purpose of the law unless the literal rule is leading to absurdity. Pledge falls under agreeing to sale

[4] Oriental Insurance Co Ltd v/s Hansraibhai V Kodala [2000] 105 Comp Cas 743 (SC)

[5] Union of India v/s Tata Chemicals Ltd 2014(5) ABR698 (SC)



but it is not actual sale. Therefore, it appears that transaction of pledge do not require disclosure under regulation 7(2). Whether, SEBI really wants to exclude pledge from this disclosure requirements is unknown, however if SEBI intends otherwise, this is one area which may require immediate correction.

Recently in case of Ms. Vandana Singh, a designated person in Biocon Limited[6], SEBI clearly decided that invocation of pledge by lender will amount to trade and therefore will require pre clearance! There have been some instances where financing schemes are made available with respect to ESOP shares. If pledge is exempt from disclosure requirements, many times there can be an attempt to circumvent PIT Regulations.

In majority occasions, language of PIT Regulations have been kept open ended, so that wrong doer should not escape compliance of PIT Regulations, however this is the occasion where not using of word 'trade or trading' does not seem to meet the objective!

Why 'relative' definition under 1992 Regulations have been narrowed down to 'Immediate Relative' definition under PIT Regulations 2015?

If we look at legislative note below regulation 6 (2)[7], it specifically casts responsibility on the person making disclosure under Chapter III of PIT Regulations, 2015 to include trading done by such person's immediate relatives, and every other person for whom such person takes trading decisions!

Disclosure obligations under Chapter III is on promoter, promoter group, designated persons, directors, and while calculating thresholds for making disclosures, they have to take cognizance about the trades done by their immediate relatives and every person for whom these persons take trading decisions and accordingly make disclosures. This is a very important principle and which is very logical.

When we look at definition of immediate relative under regulation 2(1)(f) of PIT Regulations 2015, "immediate relative" means a spouse of a person, and includes parent, sibling, and child of such person or of the spouse, any of whom is either dependent financially on such person, or consults such person in taking decisions relating to trading in securities." This definition says spouse of person is considered as immediate relative without applying any other principle. Further it includes parent, sibling, and child of such person or of the spouse if, such relative consults such person in taking decisions relating to trading in securities. If such relative is dependent financially on such person, it would be presumed that such relative is consulting or can be influenced by such person. Even from this principle it appears that relatives who depend on such person for taking trading decisions only needs to be covered under immediate relative category. And provisions of regulation 6(2) are going beyond immediate relative. If this is the principle, it is clueless as to why PIT Regulations have narrowed down the relative definition under Companies Act, 2013 to immediate relative? Whether these words serve the cause or actually hamper it! There have been instances where persons accused have argued on the definition of relative / immediate relative to say that from the context of Designated Person the person is not relative (although from the context of that person who is accused, Designated Person is relative!). Such arguments can be successful at appellate forum because regulations may seem to be supporting such arguments. Now it is interesting to note that immediate relative is an inclusive definition and therefore one may argue that the list of relatives is illustrative list and not exhaustive list, however it would be apt if SEBI considers changing the definition of immediate relative where first the principle is laid down and then definition may cover spouse as deemed immediate relative and other relatives if they meet either of two criteria's i.e. (1) relative is dependent financially on the person OR (2) relative consults such person while making decisions about trading in securities!

Whether every sharing of UPSI require compliance of regulation 3(3)(ii) of PIT Regulations 2015?

Regulation 3 (1) casts responsibility on insiders not to share UPSI unless it is for legitimate purpose. Further regulation 3(3) starts with words – "Notwithstanding anything contained in this regulation" that means this is overriding provision over other regulations.

Further clause (ii) of Regulation 3(3) says- "(1) an unpublished price sensitive information may be communicated, provided,

> One cannot go to find the purpose of the law unless the literal rule is leading to absurdity. Pledge falls under agreeing to sale but it is not actual sale. Therefore, it appears that transaction of pledge do not require disclosure under regulation 7(2). Whether, SEBI really wants to exclude pledge from this disclosure requirements is unknown, however if SEBI intends otherwise, this is one area which may require immediate correction.

[6] *SEBI Adjudication Order No. AP/SK/2020-21/9436 dated 23 October 2020 in the matter of Biocon Ltd*

[7] *Legislative note below Regulation 6(2) - "These regulations are primarily aimed at preventing abuse by trading when in possession of unpublished price sensitive information and therefore, what matters is whether the person who takes trading decisions is in possession of such information rather than whether the person who has title to the trades is in such possession"*

allowed access to or procured, in connection with a transaction that would not attract the obligation to make an open offer under the takeover regulations but (2) where the board of directors of the listed company is of informed opinion that sharing of such information is in the best interests of the company and (3) the information that constitute unpublished price sensitive information is disseminated to be made generally available at least two trading days prior to the proposed transaction being effected in such form as the board of directors may determine to be adequate and fair to cover all relevant and material facts.

This regulation 3(3)(i) specifically talks about sharing of UPSI with respect to transaction which entails / triggers open offer. However regulation 3(3)(ii) does not indicate which type of transactions are contemplated here. Plain reading appears that whenever company wants to share any UPSI for any transaction, it should be first approved by the board of directors of that listed company and second the UPSI shared in that transaction should be disclosed on stock exchange two trading days prior to giving effect to the said transaction. This would mean that, if any technological collaboration is being worked out, and for that purpose if Company shares any information which is not generally known and upon becoming public can impact price, such sharing of information requires approval of board of directors and that information also needs to be disseminated two trading days prior to entering into that technology collaboration agreement! Imagine a situation where every UPSI shared for legitimate purposes if it is required to be disclosed on stock exchange, will it help business of that company? And then will it help the investors of that company? Will competitors not take advantage of this situation?

Upon reading para 47 of Sodhi Committee, it reveals that regulation 3(3) was proposed in the context of transaction where any acquirer or investor is undertaking any due diligence of the Company and based on due diligence findings, he is going to decide about investing in the Company! And therefore regulation 3(3) actually expects that when list company allows any due diligence to large investors, share same information with other investors as well! Neither this back ground nor reference of due diligence is appearing in regulation 3(3) of PIT Regulations. In an attempt to make provisions very wide, it has resulted into a situation where no one can comply with this in literal sense. If regulation 3(3) clarifies which transactions are contemplated under it, it will make job of compliance officer bit easy.

CONCLUSION

In last 7 months SEBI has passed more than 50 adjudication/ settlement orders. SEBI is right in its approach of not granting blanket exemptions from compliance with PIT Regulations so that no one mis-uses it. However at some places appropriate guidance or amendment may lead to appropriate practices which will help compliance officers and companies to meet the objective of investor protection.