

The Indian Landscape of Insider Trading

Understanding Regulations, Managing Risks, and Upholding Ethical Governance for Board Members

Insider trading refers to the practice of trading a company's securities based on Unpublished Price Sensitive Information ("UPSI"), which is not available in the public domain. UPSI encompasses any information that, when made public, can significantly influence the prices of securities. To determine whether information is UPSI two key criteria are checked: (i) whether the information is generally not accessible to the public; and (ii) whether its publication can affect stock prices.

Important legal provisions

The erstwhile Companies Act, 1956, did not address insider trading. However, after the Securities and Exchange Board of India (the "SEBI") was formed in 1988, the regulation of insider trading became a focused endeavour. Section 12-A of the SEBI Act, 1992 (the "Act"), granted the SEBI the authority to regulate insider trading practices and to issue regulations accordingly. The SEBI introduced the SEBI (Prohibition of Insider Trading) Regulations 2015, (the "Regulations"), which have been amended over time.



***Mr. Akil Hirani**
Managing Partner
Majmudar & Partners



Board members have a critical responsibility to monitor trading activities within the organisation and report any suspicious behaviour that can indicate insider trading.

An “Insider” is defined as anyone who is a Connected Person or has access to UPSI. A “Connected Person” includes relatives such as spouse, siblings and lineal descendants, partners or employees in a Connected Person's partnership, body corporates under the Connected Person's influence, and members of a Hindu Undivided Family. Individuals like accountants, lawyers, advisors, auditors, and others who might not be directly employed by the company but have a role that reasonably gives them access to UPSI through professional, fiduciary, or contractual relationships are also included.

As per Regulation 2(e) of the Regulations, the term “generally available information” refers to information that is accessible to the public without bias and excludes unverified reports in the media. This provision clarifies as to what qualifies as UPSI and what does not, ensuring that only truly sensitive information falls under the insider trading regulations.

Implications for board members

For board members, the implications of the Regulations are profound. Directors are considered insiders under the Regulations because they are, by virtue of their positions, privy to sensitive information that can influence market behaviour. The SEBI is continuously monitoring price movements of traded shares and the trades being

higher. Beyond financial penalties, those found guilty may face imprisonment and disqualification from future directorships, severely damaging their careers. The reputational harm extends to the company as well, as it erodes trust of shareholders, investors, and the public, which can lead to significant long-term financial consequences.

In *PVP Ventures v. Securities & Exchange Board of India*, the SATM imposed a penalty of INR300 million (~US\$360,000) on PVP Global Ventures and its promoter for insider trading. The promoter was found to have traded shares of PVP Ventures while possessing UPSI related to negative financial results, and he failed to make the necessary disclosures.

“

Ignorance or complacency is not a defense, as the consequences of insider trading violations are severe and can have long-lasting impacts on the organisation's reputation.

effected, which means that directors are at a higher risk of being scrutinized for insider trading violations. Therefore, directors must exercise extreme caution in all their dealings, both within and outside the boardroom.

The consequences of violating insider trading regulations are severe, both legally and reputationally. Under Section 15G of the Act, penalties for insider trading can range from INR 1 million (~US\$ 12,000) to INR 250 million (~US\$ 300,000) or three times the profits gained, whichever is

It is not enough for board members to avoid trading on UPSI themselves. They must also ensure that they are not inadvertently sharing price sensitive information with others who might use it improperly. The inclusive nature of Regulation 2(1)(d)(ii) means that even conversations with family members, friends, or professional advisors can potentially lead to insider trading violations if UPSI is disclosed and forms the basis of trades effected by “connected persons.”

Do's and Don'ts: Avoiding communication pitfalls

To mitigate the risk of insider trading, board members must be vigilant about communications that may inadvertently disclose UPSI. Insiders are strictly prohibited from sharing or providing access to UPSI unless it is for

legitimate purposes, performance of duties, or legal obligations. This restriction extends to all communications related to a company or its securities, whether listed or proposed to be listed.

As such, board members must ensure that any sharing of UPSI occurs solely in the ordinary course of business and with partners, collaborators, or advisors who need the information to fulfill their roles and must maintain strict confidentiality.

Moreover, when transactions require the dissemination of UPSI, such information must be made generally available at least two trading days before the transaction. In addition, boards must put in place strict confidentiality agreements and maintain a structured digital database that records the nature of UPSI shared, the identities of those involved, and timestamps for audit purposes. This database must be preserved for at least eight (8) years to ensure compliance in case of investigations.

Do's and Don'ts: Establishing clear policies and procedures

Board members must ensure that their organisations have clear and comprehensive policies regarding the handling of UPSI. This includes implementing and regularly updating a code of conduct. These policies and the code of conduct must outline strict protocols for information sharing and specify the steps that must be taken to protect UPSI. Board members must also enforce mandatory training for all employees and connected persons, ensuring that each individual is aware of their obligations under the Regulations. By promoting a culture of compliance and vigilance, board members can significantly reduce the risk of insider trading incidents within their organisations.

Do's and Don'ts: Avoiding conflicts of interest

Board members must be cautious about potential conflicts of interest that may arise from their dual roles as corporate leaders and individual investors. They must avoid participating in any trading activities that could be perceived as a form of benefit from their access to UPSI. Additionally, members must ensure that their personal financial interests do not interfere with their fiduciary duties to the company. Establishing personal trading plans that comply with the Regulations and receiving prior approval from the compliance department of the

company before executing trades are prudent steps to prevent conflicts.

Do's and Don'ts: Monitoring and reporting suspicious activities

Board members have a critical responsibility to monitor trading activities within the organisation and report any suspicious behaviour that can indicate insider trading. Regular audits and reviews of trading patterns, especially among those with access to UPSI, are essential to detect potential violations early. Boards must also establish a robust whistleblower policy that encourages employees and connected persons to report any concerns related to insider trading without fear of retaliation. Immediate action should be taken to investigate and address any potential breaches of the Regulations. Actively monitoring and enforcement of compliance by board members can uphold the company's ethical standards and avoid the severe consequences of insider trading violations.

M&A guidelines for the board

During a merger or acquisition (“M&A”) transaction, one of the significant challenges is managing the communication of UPSI to a potential buyer without violating insider trading regulations.

Regulation 3(3) allows the sharing of UPSI during due diligence for M&A transactions, provided it is for legitimate purposes and serves the best interests of the company. However, this exception can create complications, particularly in determining whether the disclosure of information is necessary and how it might impact other stakeholders. Additionally, Regulation 3(5) requires companies to document the board's opinion that sharing UPSI is in the best interests of the company, yet the regulation does not clearly define the criteria for forming such an opinion, adding another layer of complexity.

To mitigate the risks of insider trading during M&A transactions, board members must strictly adhere to Regulation 3. Firstly, directors and officers should be promptly informed of potential trading restrictions early in the M&A process. This ensures compliance with the prohibition on trading on UPSI. Board members must also evaluate whether the transaction is material under Regulation 2(1)(c). If deemed material, it is essential to impose trading blackouts for insiders to prevent any misuse of non-public information.



In line with Regulation 3(2A), board members should establish strict procedures to limit access to UPSI during the M&A process. Knowledge of the transaction should be confined to a core group, directors, and advisors to maintain control over sensitive information and minimize the risk of inadvertent insider trading violations. These steps are critical to ensuring regulatory compliance and upholding the integrity of the transaction.

Silent period

In accordance with best practices and to uphold the principles of fair trading, it is essential for the board to enforce a silent period before the release of a company's financial results. Although the Regulations do not explicitly mention of a "silent period," Regulation 4 underscores the prohibition of trading on UPSI around the time of release of a company's financial results. To align with these principles, companies, typically, implement a silent period of 15 to 30 days prior to the announcement of financial results, during which directors, officers and other insiders are restricted from trading the company's securities.

The silent period serves to prevent any misuse of confidential financial information that can unfairly benefit insiders before the information becomes publicly available. By restricting trading during this critical period, the board minimizes the risk of insider trading and maintains investor confidence by ensuring that all market participants have equal access to the financial data once disclosed.

Adherence to trading plans

Under Regulation 5(2)(v), trading plans for insiders must now specify the value or number of securities and the nature of the trade. Clear price limits have been set, with

buy trades capped at 20% above and sell trades at 20% below the previous day's closing price. Further, the Regulations now allow for the splitting of large insider trades over a specified period, which serves to reduce market disruption and prevents sudden price swings, and the waiting period for insiders to trade has now been shortened from 6 months to 120 days.

Conclusion

The role of directors in preventing insider trading cannot be overstated. Given their access to sensitive UPSI, directors are uniquely positioned to uphold a company's reputation and the integrity of the market. The stringent regulations prescribed by SEBI, particularly the comprehensive scope of who qualifies as an insider and the severe penalties under Section 15G of the Act, emphasize the critical need for vigilance.

Board members must prioritize strict adherence to the regulations, implement robust internal policies, and remain proactive in monitoring compliance within their organisations. This includes preventing any personal conflicts of interest and ensuring that all employees and connected persons are fully compliant with and aware of the regulatory requirements. Further, in an ever evolving regulatory landscape, with amendments being introduced regularly to close loopholes and enhance transparency, board members need to stay informed and responsive to changes. Ignorance or complacency is not a defense, as the consequences of insider trading violations are severe and can have long-lasting impacts on an individual's career and an organisation's reputation.

A commitment to ethical governance is essential for maintaining the trust of shareholders, investors, and the broader public. ■

***Mr. Akil Hirani** is the Managing Partner and Head of Transactions at Majmudar & Partners, an international law firm based in India. With extensive expertise in corporate law, cross-border transactions, and regulatory matters, he guides multinational companies through complex legal landscapes. His practice encompasses mergers and acquisitions, joint ventures, corporate restructuring and more.