The need to know principle is universally acknowledged. Yet it is often given the go-by without fear of consequences. Amendment in PIT Regulations, SEBI's latest diktat, lays down the markers.

Editor

"PIT" FALLS AND POTHOLES

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"Those who know do not speak. Those who speak do not know."
- Lao-Tzu

If securities market regulators had a wishlist, the first part of Lao-Tzu's observation would rank very high. In an ideal market, with greed being non-existent, and with unjust enrichment being frowned upon, Unpublished Price Sensitive Information (UPSI) will be internalised and absorbed, and shared only with those that need to know.

The real world is a lot different. With asymmetry of information being one of the two major negatives in a securities market, regulators have to work overtime to ensure that the person who has information that is better, faster and more complete, does not translate it to her/his financial benefit. In attempting to strike at the root of this evil, the Indian regulator has drawn the battlelines differently. Whereas in many jurisdictions, trading on the basis of UPSI is an essential ingredient for the offence to be complete, in India, the mere sharing of information with persons who are not entitled to such information, and even enabling the access, of unauthorised persons, to such information, is in itself an offence.

There is a large universe of persons to whom the regulatory restrictions apply. The large body of "Insiders" includes a connected person as well as a person in possession of, or having access to, UPSI. Immediate relatives, defined to, inter alia, include either financially dependent persons or persons in the habit of consulting the insider in taking decisions relating to trading in securities, also fall within the ambit of "connected persons".

Since the late 1980s, and especially with SEBI being set up as a statutory organisation in 1992, India, like most other jurisdictions, opted for a disclosure based regime in the securities market. Simply put, a disclosure based regime makes it incumbent on those seeking to raise capital, or those carrying on business, to make, on a continuing basis, all disclosures that are relevant for the entire body of stakeholders to take informed decisions. "Publicise or perish" became the regulatory edict. Consistent with this regulatory philosophy, changes have been, and are continuing to be, made in regard to the Prohibition of Insider Trading Regulations (the Regulations).

Normal jurisprudence casts the responsibility, of proving an allegation, on the person making the allegation. The area of insider trading, and the prohibition attached to the passing on of information in an unauthorised manner, or enabling access to such information, is one instance where jurisprudence is being stood on its head. Once a person is in possession of UPSI and carries out trade in securities, there is a presumption that she/he acted on the basis of UPSI. It is for that person to prove the absence of a causal relationship between possession of UPSI and trading in securities. As in the case of many other laws and regulations, there has been a carveout of the circumstances in which such trades can be proved to be legitimate, but that does not detract from the general proposition that the burden of proof lies on the person complained against.

Information, like money, is admittedly the lifeblood of business. It follows, that persons that need to know, in the company's interest, must receive information and must have access to information. To address this requirement, a number of categories of persons such as partners, collaborators, lenders, customers, suppliers, merchant bankers, legal advisors, auditors, insolvency professionals and other advisors or consultants have been included in the list of persons to whom UPSI may flow, provided that the purpose is legitimate. This long list of persons leaves one wondering whether what is being taken with one hand is being given away with the other. Persons included in this list, and receiving UPSI pursuant to a legitimate purpose, shall be considered Insiders and shall be given due notice to maintain confidentiality of such UPSI. It would be left to the Board to craft such confidentiality agreements, as do not leave loopholes for persons to evade or circumvent the prohibitions of these Regulations.

The Board has also been tasked with ensuring that the CEO formulates a code of conduct, with its approval, to regulate, monitor and report trading by its Designated Persons and immediate relatives of Designated Persons. It does not stand to reason that a CEO, whose principal responsibility is to run the business in a manner consistent with the interest of stakeholders, should be charged with this additional responsibility of formulating a code of conduct considering that this would seem to fall squarely within the responsibility of the Compliance Officer.

Elsewhere in the Regulations, auditors, accountancy firms, law firms, analysts, insolvency professional entities, consultants, banks etc. who are assisting or advising listed companies, have been referred to as fiduciaries for the purpose of the Regulations. The conduct of their Designated Persons (along with their immediate relatives) would also be required to conform to a code of conduct that they would be required to put in place.

Schedule B of the Regulations, which lays down the minimum standards for code of conduct for listed companies to regulate, monitor and report trading by Designated Persons, provides inter alia, in the language of the Regulations, that "the gap between clearance of accounts by audit committee and board meeting should be as narrow as possible and preferably on the same day to avoid leakage of material information." It is entirely possible that this stipulation arose on account of a few incidents of material information being leaked between audit committee meetings and board meetings. The solution prescribed is worse than the problem. Companies that treated audit committee meetings as a formality to be gone through for a few minutes before board meetings, would now happily comply with this stipulation. Other companies with multiple businesses, and of reasonable size, will have to reconsider whether the present practice of having audit committee meetings in the afternoon of the day prior to the board meeting should be revisited. One major fallout will be that the audit committee would not be left with enough time to go through the voluminous documents, absorb the information contained therein, and take decisions or make recommendations thereon. The problem is compounded by the fact that the mandatory workload of audit committees has been increasing and therefore adequate time for their meetings is of the essence. One failsafe solution would be for the Regulator to mandate that all audit committee meetings should take place on Friday afternoon, after market hours, and that the board meetings could take place on Saturdays, which are non-trading days. A positive fallout of such a step would be that a number of board meetings would take place at the same time and make it a little more difficult for Independent Directors who are on an unacceptably large number of boards and committees.

The burden of knowledge was never known to be so heavy. Rightly has it been observed that where ignorance is bliss, it is folly to be wise. The last word must necessarily belong to George Bernard Shaw who remarked - *"The things most people want to know about are usually none of their business."*

READERSPEAK - DIVIDE AND RULE

Vikram Singh Mehta, Executive Chairman, Brookings India
"Such a well written, timely and comprehensive article."

Shailesh Dhuri, Executive Director, Decimal Point Analytics
"Excellent article."

Do let us know of any specific issues you would like to see addressed in subsequent issues.