

Insider Trading Regulations: SEBI Tightens the Noose

Key Takeaways

- Scope of Unpublished Price Sensitive Information has been expanded
- Most events/information requiring disclosure under the Listing Regulations will now be treated as UPSI
- Insiders will need to be mindful of the widened scope of UPSI, though the regulator has introduced flexibility by easing the trading plans framework
- Category of 'deemed connected persons' has also been expanded, capturing a wider range of entities and individuals – possibly even house helps

SEBI, in December, notified several important amendments to its SEBI (Prohibition of Insider Trading Regulations), 2015 ("**PIT Regulations**"). Drawing from its experience with listed companies not fully adhering to the spirit of the law and litigation surrounding some of its orders, SEBI has responded by embracing the idea that "sunlight is the best disinfectant". The changes aim to tighten the regulatory framework by reintroducing stricter standards and addressing gaps that crippled effective enforcement.

UPSI Scope Broadened: Price Sensitivity vs Materiality

The purpose of SEBI's PIT Regulations is to prevent market manipulation and protect the integrity of the securities market by ensuring that individuals with access to unpublished price sensitive information ("**UPSI**") do not misuse it for personal gain. To that effect, what constitutes UPSI becomes crucial.

The PIT Regulations define it as:

> *"any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following:*
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> *(i) financial results;*
> *(ii) dividends;*
> *(iii) change in capital structure*
> *(iv) mergers, demergers, acquisitions, delistings, disposals and expansion of business and such other transactions;*
> *(v) changes in key managerial personnel."*

UPSI's History: The regulatory stance on what should constitute UPSI has oscillated from being principle-based to more prescriptive.

Prior to 2018, the definition of UPSI was tied to material events outlined under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**Listing Regulations**"). However, after feedback from the Fair Market Conduct Committee[1], which was of the view that not all material events are necessarily price-sensitive, SEBI sought public input. This led to the un-linking of UPSI from Listing Regulations, effectively narrowing its scope.

However, this recalibration had unintended consequences. Despite the broad, inclusive nature of the definition, companies largely interpreted UPSI as covering only the five explicitly listed events, significantly restricting its application. SEBI observed that companies were not exercising the prudence and sound judgment expected of them in accurately categorizing events as UPSI.

[1] Report of Committee on Fair Market Conduct.

The regulator had to evidence before the Securities Appellate Tribunal ("**SAT**") on multiple occasions that events/information which required disclosure under the Listing Regulations should've also been categorised as UPSI under PIT Regulations.

For instance, the B Renganathan case[2], where SEBI observed that an acquisition to grow a business vertical – a move likely to impact revenue and profits – was disclosed under the Listing Regulations but not treated as UPSI. The compliance officer failed to close the trading window, and the company's share price rose by 4.79% in one day. SEBI concluded that this constituted price-sensitive information, which was upheld by the SAT.

Similarly, in its case against ICICI Bank[3], SEBI noted that the bank failed to timely disclose a Binding Implementation Agreement with the dominant shareholders of the Bank of Rajasthan. The failure to disclose the event in a timely manner resulted in insider trading committed by various entities in the scrip of Bank of Rajasthan. On appeal, the SAT had ruled in favor of SEBI to say "*the purpose and spirit of disclosure in a disclosure-based regulatory regime is simple and clear; disclose all material and price sensitive events/information and disclose even when one is in doubt. It does not have to be tested with finer legal examination, hairsplitting arguments or semantics*."

Change In Regulatory Stance: Cases like these prompted a rethink of UPSI's scope. So, on May 18, 2023, SEBI issued a consultation paper[4] recommending the re-linking of material events under Reg. 30 to UPSI. However, public feedback indicated that not all material events are inherently price-sensitive, calling for a more balanced approach.

To address the concerns raised in the May consultation paper, SEBI proposed a refined solution: a precise list of events from Reg. 30 of the Listing Regulations that are both material and price-sensitive, ensuring clarity without overprescription.

On November 9, 2024, SEBI issued a follow-up consultation paper[5] seeking public comments on 13 events that may be added to the definition of UPSI.

This was taken up in SEBI's board meeting[6] on December 18 post which the regulator identified the following events for potential inclusion (fine print yet to be notified):

1. Changes in credit ratings other than ESG ratings
2. Fund-raising proposed to be undertaken
3. Agreements (by whatever name called) impacting management or control of the company
4. Initiation of forensic audit

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[2] Adjudication Order No. Order/KS/VC/2020-21/8265.
[3] Before the SAT - Appeal No. 583 of 2019.
[4] SEBI Consultation Paper dated May 18, 2023, proposing changes to 'UPSI' definition.
[5] SEBI Consultation Paper dated 09 November, 2024 reviewing definition of UPSI.
[6] SEBI Board Meeting dated December, 18, 2024.

5. Fraud or defaults by a listed entity/ its promoter/director, key managerial personnel/senior management or subsidiary or arrest of key managerial personnel, senior management, promoter or director of the listed entity, whether occurred within India or abroad
6. Change in key managerial personnel (other than due to superannuation or end of term), and resignation of a Statutory Auditor or Secretarial Auditor
7. Resolution plan/ restructuring/one time settlement of loans/borrowings
8. Admission of insolvency proceedings, approval/rejection of resolution plan
9. Action(s) initiated or orders passed by any regulatory, statutory, enforcement authority or judicial body against the listed entity or its directors, key managerial personnel, senior management, promoter or subsidiary, in relation to the listed entity.
10. Award/termination of order/contracts not in the normal course of business
11. Outcome of any litigation/dispute(s) which may have an impact on the company
12. Giving of guarantees/becoming a surety not in the normal course of business
13. Granting, withdrawal, surrender, cancellation or suspension of key licenses or regulatory approvals

In the board meeting, SEBI also decided to apply the materiality thresholds under the Listing Regulations to UPSI.

Out of the 13 proposed events for inclusion in the definition of UPSI, some of the events are derived from Para A (*Events to be disclosed without any application of the guidelines for materiality*) of Part A of Schedule III of Listing Regulations, while some are derived from Para B (*To be disclosed upon application of the guidelines for materiality*). For events included from Para B, materiality thresholds under Reg. 30(4)[7] will apply to determine if they qualify as UPSI. For instance, the outcome of litigation or disputes, which originates from Para B, will require the application of materiality thresholds to assess whether it constitutes UPSI.

For events emanating from outside the company, flexibility has been provided to make entries in the structured digital database on a deferred basis, within two days, as well as to not have mandatory trading window closure. This has been done to enhance the ease of doing business for listed companies.

The Issue with the New Stance: During the consultation period, stakeholders expressed concerns about some genuine difficulties insiders may face.

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[7] The listed entity shall consider the following criteria for determination of materiality of events/ information:
- *a. the omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or*
- *b. the omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date; or*
- *c. the omission of an event or information, whose value or the expected impact in terms of value, exceeds the lower ofthe following:*
  - *1. two percent of turnover, as per the last audited consolidated financial statements of the listed entity;*
  - *2. two percent of net worth, as per the last audited consolidated financial statements of the listed entity, except incase the arithmetic value of the net worth is negative;*
  - *3. five percent of the average of absolute value of profit or loss after tax, as per the last three audited consolidated financial statements of the listed entity;*
- *d. In case where the criteria specified in sub-clauses (a), (b) and (c) is not applicable, an event or information may be treated as being material if in the opinion of the board of directors of the listed entity, the event or information is considered material:*

For instance, the potential closure of trading window for extended periods given that a larger number of events/information will qualify as UPSI. A company has to close the trading window when the compliance officer determines that a designated person or class of designated persons can reasonably be expected to have possession of UPSI. Insiders such as CEOs and senior executives, who are in perpetual possession of UPSI, may find it difficult to deal in securities of the company.

To address these concerns, SEBI amended the provisions of trading plans under the PIT Regulations in September 2024 to provide greater flexibility. These changes were implemented before amendments to the definition of UPSI, ensuring that stakeholders can navigate the broader scope of UPSI without facing undue restrictions on their trading activities.

The key changes to trading plans are captured below:

Parameter	**Pre-amendment**	**Post-amendment**
Cool-off Period	6 months	120 calendar days
Minimum Trading Plan Period	12 months	None
Black-out Period	Trades during black-out period were prohibited	No such restrictions now
Specific Trading Dates or Periods	Required to specify either the value of trades to be effected or the number of securities to be traded, along with the nature of the trade and the intervals or dates on which such trades would occur	Disclose either a specific date or a time period not exceeding five consecutive trading days, while other disclosures remain the same
Price Limits	Not allowed	Option to establish a price +/- 20% of the buy / sell trades respectively based on the closing price on the day before the submission of the trading plan. Insider may make adjustments, with the approval of the compliance officer, in the number of securities and price limit in the event of corporate actions (e.g., bonus issue, stock split).

Contra-Trade Restrictions	Not applicable to trades executed pursuant to trading plans	Applicable
Non-execution of Trading Plans	No such provision	Allows for non-execution of trading plan in cases such as permanent incapacity, bankruptcy, operation of law, etc.
Approval / Rejection of Trading Plan	No specific approval timeline	The compliance officer shall approve or reject the trading plan within two trading days of receipt of the trading plan and notify the approved plan to the stock exchanges on which the securities are listed, on the day of approval.

To illustrate, assume the CFO of Company X submitted a trading plan on January 1, 2024. Shortly after, Company X decides to engage with investors to raise funds, which later receives board approval. Under the previous regulations, the CFO could not execute the trading plan until June 30, 2024, due to the mandated 6-months cooling-off period from the disclosure date. However, under the amended regulations, the CFO can execute the trading plan by May 1, 2024, as the cooling-off period has been reduced to 120 days. The rationale behind this change is that a 120-day period is now considered sufficient for the fundraising information to become public, enabling earlier execution of the trading plan while preventing insider trading based on UPSI.

'Deemed Connected Person': Balram Garg Aftermath

SEBI observed that the existing definition of 'connected person' was too narrow to include all those who may be closely associated with such persons. To address this, SEBI floated a consultation paper[8] in July 2024 proposing amendments to expand the definition of 'connected person.' Now, the regulator has notified the amendment effective December 6, 2024.

A 'connected person'[9] is a person who has a connection with the company that is expected to put him in possession of/give him access to UPSI.

So far, 'deemed connected persons' included immediate relatives of connected persons, parent/ associate/subsidiary companies, etc. Now the definition will also include:

[8] SEBI Consultation Paper dated July 29, 2024, on proposed amendments to the SEBI (Prohibition of Insider Trading) Regulations, 2015 to rationalize the scope of the expression 'connected person', while not increasing compliance requirements.
[9] Reg. 2(1)(d) of PIT Regulations.

- Relatives[10] (as against 'immediate relative' so far)
- Firm/its partner/its employee where a connected person is also a partner
- Persons sharing residence with a connected person

The expansion in the definition aims to cover individuals/entities who, owing to their proximity and close relationship with the connected persons, are considered to be in such a position where they can potentially indulge in insider trading.

Consequences of becoming a 'deemed connected person': Once an entity or individual is classified as a 'deemed connected person', the onus of proving that they were not in possession of UPSI shifts to them. This creates a rebuttable presumption in favor of SEBI. Consequently, the regulator will not be required to demonstrate that UPSI was actually communicated, as these individuals or entities will be presumed to have access to UPSI.

The amendments can be attributed to the outcome in the Balram Garg v. SEBI[11] case, wherein it was alleged that the appellants, who were nephews of the connected person, shared the same residence. However, the Supreme Court held that this was not a case of insider trading as they were neither 'immediate relatives' nor 'connected persons' and the onus was on SEBI to prove that there existed frequent communication between the parties.

As a result of this amendment, even house helps residing with insiders or connected persons may now be considered 'deemed connected persons'. At first glance, this may seem as a regulatory overreach, as it would require the deemed connected person to prove that a trade was bona fide and go through the attendant procedural pain of an investigation. However, it is difficult to dismiss the possibility that such individuals, being in close contact with the connected person, may have access to UPSI – and does appear to be a logical ask from the regulator. As for firm employees, one way to demonstrate the bona fides of a trade would likely involve proving the existence of effective Chinese walls within the firm to prevent insider trading.

Conclusion

Historically, companies have often relied on vague and narrow interpretations of what qualifies as UPSI. Consider scenarios where a company is raising funds or facing a credit rating downgrade – would these not have an impact on the company's share price? Clearly, they would. To argue that such events are not UPSI when they are demonstrably price-sensitive may reflect a flawed and untenable approach.

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[10] "relative" shall mean the following:
i. spouse of the person;
ii. parent of the person and parent of its spouse;
iii. sibling of the person and sibling of its spouse;
iv. child of the person and child of its spouse;
v. spouse of the person listed at sub clause (iii); and
vi. spouse of the person listed at sub clause (iv)

Note: It is intended that the relatives of a "connected person" too become connected persons for the purpose of these regulations. It is a rebuttable presumption that a connected person had UPSI.

[11] Civil Appeal No. 7054 of 2021.

The expanded scope of UPSI and the broader definition of deemed connected persons are clear indications that SEBI is tightening the noose on insider trading activities, holding more individuals and entities accountable than ever before. Companies must rethink their internal compliance frameworks to track and monitor relationships that could potentially lead to insider access. These amendments are more than just a regulatory update – they represent a fundamental shift towards greater accountability and transparency in the securities markets.

Authors





Isha Shah **Payaswini Upadhyay**

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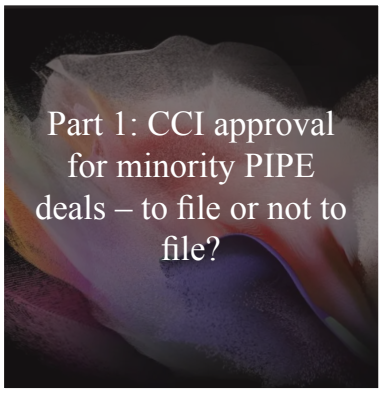
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