# SEBI seeks public comments on Report submitted by the Committee on Fair Market Conduct

SEBI constituted a Committee on Fair Market Conduct in August, 2017 under the Chairmanship of Shri T.K. Viswanathan, Ex-Secretary General, Lok Sabha and Ex- Law Secretary. The Committee was mandated to review the existing legal framework to deal with market abuse to ensure fair market conduct in the securities market. The Committee was also mandated to review the surveillance, investigation and enforcement mechanisms being undertaken by SEBI to make them more effective in protecting market integrity and the interest of investors from market abuse. The Committee comprised of representatives of law firms, mutual funds, brokers, forensic auditing firms, stock exchanges, chambers of commerce, data analytics firms and SEBI.

The committee has submitted its report to SEBI on August 08, 2018 wherein it has recommended amendments to SEBI Act,1992, SEBI (Prohibition of Insider Trading) Regulations, 2015 and SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003. A copy of the report is placed on the SEBI website at the following link:

https://www.sebi.gov.in/reports/reports/aug-2018/report-of-committee-on-fair-market-conduct-for-public-comments_39884.html

Rationale for Suggestions / Comments

Comments from public are invited on the recommendations contained in the aforesaid report in the following format:

| Chapter and sub-heading to which the comment pertains | Recommendations of Committee | Suggestions / Comments | Rationale for Suggestions / Comments |
|---|---|---|---|
| | | | |

Comments may be sent by email to Ms. Maninder Cheema, General Manager at maninderc@sebi.gov.in and Mr. Nitesh Bhati, Assistant General Manager at niteshb@sebi.gov.in latest by August 24, 2018.

# REPORT OF

# COMMITTEE ON FAIR MARKET CONDUCT

## UNDER THE CHAIRMANSHIP OF

## Dr. T. K. VISWANATHAN

## (Ex-Secretary General, Lok Sabha and Ex -Law Secretary)

## August 08, 2018

Dr. T. K. Viswanathan,
Formerly Union Law Secretary
& Secretary General Lok Sabha

August 08, 2018

**Sub: Report of the Committee on Fair Market Conduct**

**Dear Shri Ajay Tyagi,**

1. I have great pleasure in presenting herewith the Report of the Committee on Fair Market Conduct which was entrusted with the task of reviewing the legal framework for ensuring fair market conduct in the securities market and to suggest amendments to the law and regulations to bring them up to date with the current market realities.

2. SEBI, as the market regulator, has a duty to protect the interest of investors from market abuse such as fraudulent, manipulative, unfair trade practices and insider trading. A strong legal framework and strict enforcement actions are required to deal with market abuse and ensure fair market conduct in the securities market.

3. The Committee deliberated at length on the various options to address the emerging challenges and has suggested amendments in the Securities Laws to strengthen the powers of SEBI to deal with market abuse. Further, the Committee deliberated extensively on the challenges faced by SEBI in investigation and enforcement created by technology and innovation which are giving rise to new methods of fraud and new challenges.

4. This Report is an attempt by the Committee to address the challenges currently facing the securities market and I hope that it will go a long way in arming SEBI with an adequate legal framework and powers to deal with the challenges which SEBI will be called upon in the near future to meet.

5. As the Chairman of the Committee, I gratefully acknowledge the commendable contribution of the Members of the Committee who spared their valuable time and effort.

**Dr. T. K. Viswanathan**
**Chairman, Committee on Fair Market Conduct**

**To**
**Shri Ajay Tyagi**
**Chairman, Securities Exchange Board of India**

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## EXECUTIVE SUMMARY

The recommendations of the Committee are in four separate parts dealing with market manipulation and fraud, insider trading, code of conduct related to insider trading and recommendations related to surveillance, investigation and enforcement process.

### Market Manipulation and Fraud

The SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003 (PFUTP Regulations) deal with market abuse such as manipulative, fraudulent and unfair trade practices. The Committee noted that the PFUTP Regulations, as they currently stand, are a combination of rule-based and principle-based approaches of regulation and that such a combination is appropriate for the present stage of development of our markets. Based on this broad approach, the Committee has made the following recommendations:

**a.** Fraudulent, manipulative or unfair trade practices may be carried out with the aid and assistance of persons other than the parties who are transacting in the securities market, including intermediaries who may have contributed to such dealings. The prohibition of fraudulent and unfair trade practices is in the context of dealing in securities. Hence, the definition of 'dealing in securities' should also include those who assist in and indeed often orchestrate or control the dealings in securities, or those who knowingly influence the decisions to invest in securities.

**b.** Regulation 4(2) of the PFUTP Regulations lays down specific rules that prohibit certain conduct by deeming them fraudulent activities. The Committee is of the view that SEBI should regularly update the rule-based Regulation 4(2) to keep up with changes in the securities market environment. In this context, the Committee deemed it fit to reconsider each rule under Reg. 4(2) and recommended changes aimed at ensuring that the revised provisions are relevant to the present market conditions and provisions which have become obsolete pursuant to market reforms have been omitted.

**c.** The Committee also considered the issue of front entities that lend their names or trading accounts, to others. The Committee recommended that trading done by an entity in excess of verifiable financial sources should be deemed to be fraudulent, if such trading leads to any manipulation in the price or volume of the security.

**d.** The Committee noted that often, due to lack of explicit provision in the regulations, the intermediaries alone are held responsible for any fraud. This gives scope to the employees and agents of these intermediaries to escape after indulging in fraudulent activity. Hence, the Committee was of the view that the scope of the regulations should cover market participants including employees and agents of intermediaries.

**e.** The Committee considered the issue of financial statements fraud. It was felt that there is a need for SEBI to take direct action against perpetrators of financial fraud as such fraud has an adverse impact on not only the shareholders of the company but also impacts the confidence of investors in the securities markets. The Committee has recommended the inclusion of a new sub-section within the SEBI Act, 1992, which would specifically prohibit devices, schemes or artifices employed for manipulating the books of accounts or financial statements of a listed company to directly or indirectly manipulate price of a listed securities or to hide the diversion, misutilization or siphoning off public issue proceeds or assets or earnings of a listed company or to be listed company.

**Insider Trading**

The SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations) deal with market abuse of insider trading. The Committee noted that Section 15G of the SEBI Act, 1992, mentions dealing in securities 'on the basis' of unpublished price sensitive information while Section 12A mentions dealing in securities 'while in possession' of unpublished price sensitive information. Hence, the Committee has recommended that Section 15G of the SEBI Act, 1992, needs to be aligned with Section 12 A of SEBI Act, 1992, and the PIT Regulations. The Committee further observed and recommended inter alia the following changes in the PIT Regulations:

**a.** The Committee has recommended the inclusion of definitions for the terms "financial literacy", an important eligibility condition for a compliance officer, and "proposed to

be listed", a crucial factor in determining the applicability of the PIT Regulations to certain companies. Noting that all material events which are required to be disclosed as per the LODR Regulations may not necessarily be "unpublished price sensitive information" (UPSI) under the PIT Regulations, the Committee has recommended the removal of the explicit inclusion of "material events in accordance with the listing agreement" contained within the definition of UPSI.

**b.** Under Regulation 3(2) of the PIT Regulations, communication / procurement of UPSI is permitted when it is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations. The Committee has recommended that regulation 3(2) may be amended to require the board of directors of every listed company or market participants to define their own policy / definition relating to "legitimate purposes" within the contours provided under law. Further, in order to give some illustrations of legitimate purpose, the inclusion of an explanation has been recommended. Every listed company / market participant shall be required to maintain an electronic record containing the names of person with whom UPSI is shared and the nature of the UPSI.

**c.** The Committee noted that, during the preliminary / nascent stages of a proposed transaction, it may not be possible for the board of directors of the target listed company to opine whether such proposed transaction is in the best interests of such target listed company. Hence, the Committee has recommended that the board of directors may instead evaluate and opine on whether the sharing of the UPSI for due diligence is in the best interests of the company.

**d.** The Committee has recommended certain amendments to the defences available in the PIT Regulations. The defence available for off-market inter-se transfers between promoters, who were in possession of the same UPSI, may be extended to non-promoters also provided that the possession of UPSI is not as a result of information shared for the purpose of conducting due diligence for acquisition transactions. New defences may be included for transactions carried out through the block deal window mechanism among persons possessing the same UPSI, for transactions carried out

in a bona fide manner pursuant to a statutory or regulatory obligation, and for transactions undertaken pursuant to the exercise of stock options.

**e.** The Committee noted that trading plans continue to remain unpopular as far as promoters and perpetual insiders are concerned. However, it could not arrive at a consensus on this issue and thus, agreed to continue with the current provisions, while clarifying that transactions pursuant to trading plans will not require pre-clearance and will not be subject to trading window norms and restrictions on contra trades.

**The Code of Conduct under Insider Trading Regulations**

The Committee noted that the PIT Regulations currently specify a common Code of Conduct applicable to listed companies, market intermediaries and other persons who are required to handle UPSI during the course of their business operations. In order to bring clarity on the requirements applicable to listed companies and others, the Committee has recommended that the PIT Regulations may be amended to prescribe two separate Codes of Conduct prescribing minimum standards for (1) Listed companies and (2) Market Intermediaries and other Persons who are required to handle UPSI. Further, the Committee has made inter alia the following recommendations:

**a.** In regard to the applicability of the Code of Conduct, the Committee has recommended that it must be made applicable only to “designated person(s)”. Further, the Committee has recommended the explanation to be included in the PIT Regulations for the term “designated person(s)” in the context of listed companies, market intermediaries and other persons.

**b.** The Committee has recommended that listed companies should initiate inquiries into any case of leak of UPSI or suspected leak of UPSI and inform SEBI promptly. The listed company should have written policies and procedures for such inquiries, which are duly approved by board of directors of the company. Listed companies should also have whistle-blower policies that make it easy for employees to report instances of leak of UPSI.

**c.** The Committee noted that investigation of insider trading is a challenging task and it is not easy to establish the link between the insiders who had access to UPSI and the persons who traded making use of such UPSI. Hence, in order to facilitate investigation, the Committee has recommended mandating disclosures by designated persons of names of immediate relatives, persons with whom such designated person(s) share a material financial relationship, and persons residing at the same address for more than one year. Such information may be maintained by the company in a searchable electronic format and may be shared with SEBI when sought on case to case basis.

**d.** The committee has recommended an institutional framework to ensure that the institution takes responsibility to formulate a code of conduct and put in place an effective system of internal controls to ensure compliance with the various requirements specified in the PIT Regulation to prevent insider trading. Further, the role and responsibility of the Board of Directors, CEO/MD, Audit Committee and Compliance officers have been clarified in this context.

**Surveillance, Investigation and Enforcement**

One of the terms of reference of the Committee was to suggest short-term and medium-term measures for improved surveillance of the markets as well as issues relating to high frequency trades, harnessing of technology and analytics in surveillance. The Committee reviewed the current processes followed by SEBI for surveillance, investigation and enforcement, and the hurdles faced by SEBI for effective enforcement of securities laws. The Committee has made inter alia the following recommendations:

**a.** The Committee endorsed the measures taken by exchanges regarding the approvals to be granted for algorithm and the need for assigning a unique identification number to each approved algorithm. The Committee made recommendations on need for brokers to self-certify compliance of algorithms with specified norms/ risk checks, and implementation of “Model Risk Checks for Algorithmic / Algo Trading”.

**b.** The Committee has recommended a two-tiered approach for investigation and enforcement wherein sensitive cases/ new types of manipulation/ cases involving large-cap companies are proposed to be handled by designated SEBI officials in a

fast-track manner, while regular cases are handled by other SEBI officials in the normal course.

**c.** The Committee has recommended that SEBI may seek direct power to intercept calls to aid in investigation, akin to the power granted to the Central Board of Direct Taxes. However, proper checks and balances must be ensured for use of the power.

**d.** The Committee has recommended a mechanism to facilitate whistleblowers to come forward and for SEBI to have the power to grant provide immunity or levy lesser penalty on such persons who come forward with full and true disclosure of alleged violations. Suitable amendments have been suggested to the SEBI Act to enable this.

The Committee is confident that the recommendations will go a long way in ensuring fair market conduct and in protecting the interest of investors in securities markets.

## INTRODUCTION

### Background and Objective

A fair and efficient Securities Market is one of the essential components of economic growth of a country. To ensure confidence, trust and integrity in securities market, the regulator of the securities market needs to ensure fair market conduct in the securities market. Fair market conduct can be ensured by prohibiting, preventing, detecting and punishing such market conduct that leads to 'market abuse'. Market abuse is generally understood to include market manipulation and insider trading and such activity erodes investor confidence and impairs economic growth.

In India, the Securities and Exchanges Board of India ("**SEBI**") is mandated to protect the interests of investors in securities and to promote the development of, and to regulate the securities market. To fulfill its duty, SEBI has been given legislative, executive and quasi-judicial powers under the SEBI Act, 1992. Over the last 30 years, SEBI, using the aforesaid powers, has made various regulations and taken stringent surveillance, investigation and enforcement measures to ensure market integrity, fair market conduct by market participants and to protect the interest of investors.

To deal with market abuse related to "market manipulation", SEBI had framed the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations in 1995. These Regulations were reviewed and replaced with the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003 ("**PFUTP Regulations**") which were notified on 17th July 2003 and thereafter, amended twice in December 2012 and September 2013 respectively.

To deal with market abuse related to "insider trading", SEBI had promulgated the SEBI (Prohibition of Insider Trading) Regulations, 1992. The 1992 Regulations were amended in 2002 to strengthen the regulations and bring in the concept of Code of Conduct for prevention of insider trading, as well as a code for corporate disclosure practices. As part of a periodic review of Regulations and to address challenges in bringing to closure cases of Insider Trading, the entire regulations were reviewed by the Sodhi Committee and were

replaced by the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**Insider Trading Regulations**" or "**PIT Regulations**").

The Supreme Court in its judgment in ***N Narayanan v Adjudicating Officer, SEBI***[1] has noted that while the Indian capital market has witnessed tremendous growth by increased participation of the public, 'market abuse' is a common practice in the securities market. The Hon'ble Court appreciated that investors' confidence in the capital market could be sustained only by ensuring investors' protection. The Securities and Exchange Board of India Act, 1992 (**the "SEBI Act**" or "**the Act**")) and the regulations made thereunder are intended to check market abuse and protect the interest of the investors in the securities market. The SEBI Act in Section 12A prohibits manipulative and deceptive devices as well as insider trading. Section 11 (2) of the Act empowers SEBI to take measures to prohibit fraudulent and unfair trade practices and to prohibit insider trading.

The Supreme Court, while considering the provisions of the SEBI Act and the PFUTP Regulations, has recognised the purpose and object of securities law as the prevention of market abuse and preservation of market integrity. The Court in the aforesaid judgment has stated:

*"Prevention of market abuse and preservation of market integrity is the hallmark of securities law. Section 12-A read with Regulations 3 and 4 of the 2003 Regulations essentially intended to preserve "market integrity" and to prevent "market abuse". The object of the SEBI Act is to protect the interest of investors in securities and to promote the development and to regulate the securities market, so as to promote orderly, healthy growth of securities market and to promote investors' protection. Securities market is based on free and open access to information, the integrity of the market is predicated on the quality and the manner on which it is made available to market. "Market abuse" impairs economic growth and erodes investor's confidence. Market abuse refers to the use of manipulative and deceptive devices, giving out incorrect or misleading information, so as to encourage investors to jump into conclusions, on wrong premises, which is known to be wrong to the abusers. The statutory provisions mentioned earlier deal with*

[1] 2013 12 SCC 152

*the situations where a person, who deals in securities, takes advantage of the impact of an action, may be manipulative, on the anticipated impact on the market resulting in the "creation of artificiality". The same can be achieved by inflating the company's revenue, profits, security deposits and receivables, resulting in price rise of the scrip of the company. Investors are then lured to make their "investment decisions" on those manipulated inflated results, using the above devices which will amount to market abuse."*

The Court also went on to succinctly outline the duties and responsibilities of SEBI in regulating and ensuring market security and protecting investors from fraud and market abuse:

*"SEBI, the market regulator, has to deal sternly with companies and their Directors indulging in manipulative and deceptive devices, insider trading, etc. or else they will be failing in their duty to promote orderly and healthy growth of the securities market. Economic offence, people of this country should know, is a serious crime which, if not properly dealt with, as it should be, will affect not only the country's economic growth, but also slow the inflow of foreign investment by genuine investors and also cast a slur on India's securities market. Message should go that our country will not tolerate "market abuse" and that we are governed by the "rule of law". Fraud, deceit, artificiality, SEBI should ensure, have no place in the securities market of this country and "market security" is our motto. People with power and money and in management of the companies, unfortunately often command more respect in our society than the subscribers and investors in their companies. Companies are thriving with investors' contributions but they are a divided lot. SEBI has, therefore, a duty to protect investors, individual and collective, against opportunistic behaviour of Directors and insiders of the listed companies so as to safeguard market's integrity."*

Today, developments in technology, information flow and access to markets have enabled new market structures to evolve and impact the way in which market manipulation occurs and new methods of market manipulation have emerged. These changes have led to the need to review the securities law dealing with market abuse and the methods used for detecting, investigating and carrying out enforcement against market abuse.

## Constitution of the Committee

Considering this dynamic nature of the securities market environment, a review of the relevant regulations and regulatory measures, assumes utmost importance in order to effectively discharge the objectives of SEBI. In view of the same, SEBI constituted the Committee on Fair Market Conduct under the chairmanship of Dr. T K Vishwanathan, Ex-Secretary General, Lok Sabha and Ex-Law Secretary as under:

| # | Members Details | Capacity |
|---|---|---|
| 1. | Dr. T.K. Viswanathan<br>Ex-Secretary General, Lok Sabha & Ex-Law Secretary | Chairman |
| 2. | Shri. Anup Bagchi<br>Executive Director, ICICI Bank Ltd | Member |
| 3. | Shri. Arun Kumar<br>Chairman & CEO, KPMG | Member |
| 4. | Shri. Ashish Kumar Chauhan<br>Managing Director & CEO, BSE Ltd. | Member |
| 5. | Shri. Haigreve Khaitan<br>Partner, Khaitan & Co. | Member |
| 6. | Ms. Kaku Nakhate<br>County Head, Bank of America Merrill Lynch | Member |
| 7. | Shri. Mihir Doshi<br>Managing Director & CEO, Credit Suisse Securities (India) Private Limited | Member |
| 8. | Shri. Milind Barve<br>Managing Director, HDFC Asset Management Company Limited | Member |
| 9. | Shri. Promeet Ghosh<br>Managing Director, Temasek Holdings (Private ) Limited | Member |

| | | |
|---|---|---|
| 10. | Shri. Rajat Sethi<br>Sr. Partner, S & R Associates | Member |
| 11. | Shri. Sunil Sanghai<br>Chair of Capital Market Subcommittee - FICCI | Member |
| 12. | Shri. Sunny Chhabria<br>Head - South Asia, Bloomberg India Private Limited | Member |
| 13. | Shri. Vikram Limaye<br>Managing Director & CEO, National Stock Exchange of India Ltd. | Member |
| 14. | Shri. Ananta Barua<br>Executive Director, SEBI (presently Whole Time Member, SEBI) | Member |
| 15. | Shri. S. Ravindran<br>Executive Director, SEBI | Member |
| 16. | Shri Gurdeep Singh<br>Chairman & Managing Director, NTPC Limited | Invitee |
| 17. | Shri Sanjiv Puri<br>Managing Director, ITC Ltd. | Invitee |
| 18. | Shri Sanjiv Mehta<br>Managing Director and CEO, Hindustan Unilever Limited | Invitee |
| 19. | Shri B N Kalyani<br>Chairman & Managing Director, Bharat Forge Ltd | Invitee |
| 20. | Shri Tony Sio<br>Head of Exchange & Regulator Surveillance, Market Technology, NASDAQ | Invitee |
| 21. | Shri Ashok Dhere<br>President, Lokmanya Seva Sang | Invitee |
| 22. | Ms. Maninder Cheema<br>General Manager, SEBI | Member Secretary |

## Terms of Reference of the Committee

The mandate of the Committee was to review relevant regulations framed by SEBI to deal with market abuse and to review the surveillance, investigation and enforcement mechanisms being undertaken by SEBI to make them more effective in protecting market integrity and the interest of investors from market abuse, with the following terms of reference:

- Identify opportunities for improvement in SEBI (Prohibition of Insider Trading) Regulations, 2015 and SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 more particularly with respect to Trading Plans, handling of UPSI during takeovers and alignment of Insider Trading Regulations with the Companies Act provisions.
- Suggest short term and medium term measures for improved surveillance of the markets as well as issues relating to high frequency trades, harnessing of technology and analytics in surveillance.

## Working Process of the Committee

The Committee held several meetings to deliberate on the issues before it. In its first meeting on September 6, 2017, the Committee decided to adopt an outcome-based approach in combination with a practice-area approach. The Committee decided to constitute subcommittees, comprising members with specialized knowledge, to deliberate and make preliminary observations / recommendations in a certain area. It was decided that suggestions / recommendations of each sub-committee would be taken up in a comprehensive manner by the main Committee for deliberation and final recommendations.

The Committee constituted the following four sub-committees to work in the following specific area:

1. Legal Subcommittee under the chairmanship of Shri. Haigreve Khaitan Partner, Khaitan & Co.

2. Code of Conduct Subcommittee under the chairmanship of Shri. Milind Barve Managing Director, HDFC Asset Management Company Limited
3. Investigation and Enforcement Subcommittee under the chairmanship of Shri. Anup Bagchi, Executive Director, ICICI Bank Ltd
4. Technology and Analytics Subcommittee under the chairmanship of Shri. Sunny Chhabria, Head - South Asia, Bloomberg India Private Limited

The subcommittees held meetings on the following dates to deliberate the issues under consideration:

- Legal Subcommittee - October 13, 2017, November 17, 2017, November 30, 2017 and April 12, 2018
- Code of Conduct Subcommittee – October 27, 2017 and April 12, 2017
- Investigation and Enforcement Subcommittee – October 4, 2017 and November 02, 2017
- Technology & Analytics Subcommittee – October 11, 2017 and November 09, 2017

The main Committee held 7 meetings on the following dates to initiate and deliberate the observations / recommendations of the subcommittees, and to finalise its recommendations:

- September 06, 2017
- December 18, 2017
- January 25, 2018
- February 06, 2018
- May 18, 2018
- May 30, 2018
- June 01, 2018

## Structure of the Report

The report is structured in four parts. The first part deals with market manipulation and suggestions relating to the SEBI (PFUTP) Regulations. The second part deals with insider

trading and suggestions relating to SEBI (PIT) Regulations. The third part deals with recommendations related to the Code of Conduct for market intermediaries, listed companies and other fiduciaries. The fourth part deals with regulatory measures to enhance surveillance, investigation and enforcement. Wherever necessary, mention has been made regarding changes needed to be carried out in the SEBI Act or the relevant Regulations.


## Acknowledgements

The Committee expresses its gratitude to Ms. Madhabi Puri Buch, Whole Time Member, SEBI for being instrumental in constitution of the Committee and her invaluable contributions in shaping the discussions of the Committee. She diverted precious time from her busy schedule to be present for all the proceedings of the Committee meetings. The Committee was ably supported by SEBI officials Ms. Maninder Cheema, General Manager, Shri Nitesh Bhati, Assistant General Manager and Shri Ankit Bhansali, Assistant General Manager who provided, secretarial assistance in addition to providing inputs to the committee and assistance in drafting of the report. Shri Vishal Padole, Assistant General Manager also provided inputs to the Committee for deliberation.

The Committee would like to acknowledge the contributions of Ms. Rachael Israel, S&R and Associates, Ms. Shruti Rajan and Shri Rohan Banerjee, Cyril Amarchand Mangaldas, Shri Moin Ladha and Shri Akshay Bhargav, Khaitan & Co, and Shri Vyom Shah, Advocate in doing research and providing background material for deliberations of the Committee and drafting of proposed amendments.

The senior SEBI officials, namely, Shri. Ananta Barua, Executive Director (presently Whole Time Member), Shri. S. Ravindran, Executive Director, Shri Anand Baiwar, Executive Director, Shri V S Sundaresan, Chief General Manager, Shri Amit Pradhan, Chief General Manager, Shri Sunil Kadam, Chief General Manager, made a valuable contribution based on their rich experience in SEBI.

The Committee also places on record the contribution of all members of the four sub-committees based on whose efforts, the Committee built up its recommendations, with special thanks to Shri Nehal Vora, BSE Ltd., Shri Sudhir Bassi, Khaitan & Co and Shri Jinendra Shah, Bank of America Merrill Lynch.

## CHAPTER 1 | MARKET MANIPULATION AND FRAUD

The SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003 (**"PFUTP Regulations"**) deals with market abuse such as manipulative, fraudulent and unfair trade practices.

### 1.1. Rule Based vs Principle Based Regulations

As innovation leads to new types of market practices, it exposes markets to new methods of fraud. Also, over time, system based controls can eliminate certain types of fraudulent practices. Hence, the question arises whether regulations need to be principle based so as to cover the broad contours of the fraudulent activity without prescribing specific details of activity that is prohibited. On the other hand, rule-based regulations are more precise, making it clear to market participants the specific conduct that is prohibited, and also reduce the burden on the regulatory system of trying to cover various acts under the principles. However, the rules become obsolete with time and may not adequately cover new practices resulting from use of technology or financial innovation which could lead to manipulative activity escaping regulatory attention.

The provisions of Regulation 3 and Regulation 4(1) of PFUTP Regulations lay down the underlying principles governing fraudulent and unfair trade practices and are intended to cover diverse situations and possibilities. Regulation 4(2) on the other hand lays down specific rules that prohibit certain conduct by deeming them fraudulent activities.[2] The Committee deliberated on the structure of the PFUTP Regulations, with focus on rule based approach vs. principle based approach to regulate the market in the light of use of new technology and new instruments, as well as new class of participants entering the markets. The Committee noted that the current structure of the PFUTP Regulations is a combination of principle-based and rule-based approaches. Thus, while Regulations 3 and 4(1) of the PFUTP Regulations enunciate broad principles and prohibit dealings in securities which were done *inter alia* in a fraudulent manner, or which employed any manipulative or deceptive device or would operate as fraud or deceit, Regulation 4(2)

[2] SEBI v Kanaiyalal Baldevbhai Patel 2017 15 SCC 1

specifies detailed rules relating to transactions which are deemed to be fraudulent or an unfair trade practice.

**Recommendation**

After deliberations, the Committee noted that such a combination of rule-based and principle-based approach is appropriate for the present stage of market development as such an approach not only enunciates the broad principles for ensuring fair markets but also enables rules to be specified to prohibit an illustrative list of identifiable unfair and manipulative trade practices. The Committee further noted that at appropriate intervals, SEBI should regularly update the rule-based Regulation 4(2) to keep up with changes in the securities market environment.

## 1.2. Scope of PFUTP Regulations

The Committee noted that market manipulation, covers a wide variety of practices undertaken to compromise the market's integrity and efficiency for one's personal gains. These would include, but not be limited to, market manipulation and fraudulent trades.

Market manipulation as a concept has been considered by the Hon'ble Supreme Court in several judgments. As defined in Palmers Company Law, and noted by the Apex Court[3], *"Market manipulation is normally regarded as the 'unwarranted' interference in the operation of ordinary market forces of supply and demand and thus undermines the 'integrity' and efficiency of the market".*

In *SEBI v Rakhi Trading*[4] the Supreme Court observed that market manipulation is a deliberate attempt to interfere with the free and fair operation of the market and create artificial, false or misleading appearances with respect to the price, market, product, security and currency.

The term 'fraud' has been interpreted by the Supreme Court at length in *SEBI v Kanaiyalal Baldevbhai Patel*[5] to be wider than 'fraud' as used and understood under the Indian

[3] N. Narayanan v Adjudicating Officer, SEBI 2013 12 SCC 152.

[4] Civil Appeal No. 1969 of 2011, DoD February 8, 2018, [2018 SCC Online SC 101]

[5] 2017 15 SCC 1

Contract Act. The term 'unfairness' has been interpreted to be even broader than and inclusive of the concepts of 'deception' and 'fraud'. Unfair trade practices are not subject to a single definition but require adjudication on case-to-case basis. Conduct undermining good faith dealings may make a trade practice unfair. The Supreme Court has defined unfair trade practices[6] as follows:

*"Having regard to the fact that the dealings in the stock exchange are governed by the principles of fair play and transparency, one does not have to labour much on the meaning of unfair trade practices in securities. Contextually and in simple words, it means a practice which does not conform to the fair and transparent principles of trades in the stock market."*

The Courts have recognized that as a matter of principle, while interpreting the PFUTP Regulations, the court must weigh against an interpretation which will protect unjust claims over just, fraud over legality and expediency over principle.[7] That being said, the Committee was of the opinion that it would be beneficial to have the PFUTP Regulations further strengthened to specifically enable SEBI to have the power to restrict such 'dealings in securities' instead of having to rely on interpretation of the PFUTP Regulations to protect the market. It was noted that in the SEBI Act and PFUTP Regulations, fraud, manipulative and unfair trade practices are referred to in the context of dealing in securities. The Committee considered whether the definition of 'dealing in securities' under regulation 2(1)(b) of the PFUTP Regulations is adequate in the context of SEBI's regulatory experience as well as observations of the Supreme Court. It was noted that while the definition of 'dealing in securities' is reasonably broad, fraudulent, manipulative or unfair trades may also be carried out with the aid and assistance of persons other than the parties who are transacting in the securities market.

**Recommendation**

Given the increasingly complicated nature of transactions in the securities market as has been demonstrated by recent experiences and the indirect role of various persons in such

[6] SEBI v Rakhi Trading Pvt Ltd 2018 SCC Online SC 101
[7] SEBI v Kanaiyalal Baldevbhai Patel 2017 15 SCC 1

manipulative transactions, the Committee is of the opinion that the definition of "dealing in securities" under Regulation 2(1)(b) of the PFUTP Regulations must also be widened to include within its ambit persons providing assistance in such dealing in securities. The Committee noted that while SEBI has been charging various persons for aiding and abetting prohibited transactions, it would be appropriate that the definition should specifically cover such persons who are indirectly participating and indeed often orchestrating and controlling such prohibited transactions. Further, as noted by the Supreme Court in *N Narayanan vs SEBI*[8], manipulation can also be achieved *by inflating the company's revenue, profits, security deposits and receivables, resulting in price rise of the scrip of the company.* The Committee noted that such actions may be done by persons who may not themselves be directly dealing in securities, but who end up influencing the dealing in securities by their manipulative or unfair actions. Thus the definition of dealing in securities must also cover such persons who by their actions influence the decisions of investors dealing in securities.

The Committee is aware that such an amendment may also bring within the ambit of 'dealings in securities', acts by intermediaries who may have contributed to such dealings. The Committee is of the opinion, in concurrence with the judgment of the Supreme Court in *SEBI v Kishore R. Ajmera*[9], that to an extent such conduct on the part of intermediaries can be attributed to negligence occasioned by lack of due care and caution which would be in contravention of the Code of Conduct governing the particular intermediary in terms of the respective Regulations. However, persistent trading would show a deliberate intention to play the market which the Committee believes should fall within the PFUTP Regulations. However, this would depend on all the surrounding facts and circumstances of the case. The Regulation should thus adequately address the issue of whether such conduct is carried out knowingly and only then consider it fraudulent.

### 1.3. Covering new types of market manipulation

The heading of Regulation 4 of PFUTP Regulations reads as Prohibition of manipulative, fraudulent and unfair trade practices. However, Regulation 4(1) mentions only fraudulent

[8] SEBI 2013 12 SCC 152
[9] 2016 6 SCC 368

and unfair trade practices. In order to ensure the consistency between the heading and principle, it would be prudent to include the words manipulative in Regulation 4(1). Further, the regulation 4(1) refers to fraudulent and unfair trade practices in securities. In order to provide more clarity that the conduct/ practices relate to entire securities market, as well as for consistency with Section 11(2)(e) of the SEBI Act, including activities such as giving advice, unauthorised trading, mis-selling, diversion of funds etc., which may impact the eco-system of securities market, it would be prudent that the regulation refers to the securities market rather than just securities.

The Supreme Court in ***SEBI v Kanaiyalal Baldev Patel***[10]**,** has stated that:

*"54. The definition of "fraud", which is an inclusive definition and, therefore, has to be understood to be broad and expansive, contemplates even an action or omission, as may be committed, even without any deceit if such act or omission has the effect of inducing another person to deal in securities. Certainly, the definition expands beyond what can be normally understood to be a "fraudulent act" or a conduct amounting to "fraud". The emphasis is on the act of inducement and the scrutiny must, therefore, be on the meaning that must be attributed to the word "induce".*

*55. The dictionary meaning of the word "induced" may now be taken note of:*

*Black's Law Dictionary, 8th Edn., defines "inducement" as "The act or process of enticing or persuading another person to take a certain course of action".*

***

*Merriam-Webster Dictionary defines "inducement" as "a motive or consideration that leads one to action or to additional or more effective actions".*

The Courts have thus repeatedly expanded the ambit of PFUTP Regulations to restrict new practices that could perpetuate market abuse:

(i) The Supreme Court has held that practices that did not disclose sufficient information about the company which was crucial for the accurate pricing of the

[10] (2017) 15 SCC 1

companies' securities and also for the efficient operation of the market fell short of the requirements of the SEBI Act and the PFUTP Regulations.[11]

(ii) The Supreme Court of India has, while recognizing that the object and purpose of the PFUTP Regulations is to curb 'market manipulation', decided that front running by non-intermediaries may be brought under the prohibition prescribed under Regulations 3 and 4(1) of the PFUTP Regulations, for being fraudulent or unfair trade practice. [12]

(iii) The Supreme Court, in a case related to trades where one party consistently made loss in a preplanned and rapidly reversed trades in the derivative segment, held that such trades were non-genuine and were deemed to be an unfair trade practice. The Court did not distinguish between trades in the cash and F&O segment in this regard and held that orchestrated trades are a misuse of the market mechanism.[13]

The judgments of the Supreme Court of India exemplify the necessity for regulation to adequately deal with the novel methods of market abuse, fraud and market manipulation that have been encountered by SEBI in recent instances.

Having regard to the aforesaid judgments and the experience of SEBI in dealing with manipulations as specified under Regulation 4(2), the Committee noted that when the market practice/ trading falls under Regulation 4(2), the element of fraud is deemed to exist and there need not be any separate burden cast on SEBI to prove existence of fraud. In this context, the Committee deemed it fit to reconsider each rule under Reg. 4(2) and ensure that there are adequate safeguards in the deeming provisions.

**Recommendations**

1. Reg 4(2) (a) deems any act which creates false or misleading appearance of trading to be fraudulent. The word "*knowingly*" may be added before the rule so as to exclude inadvertent or accidental trades.

[11] N. Narayanan v Adjudicating Officer, SEBI 2013 12 SCC 152
[12] SEBI v Kanaiyalal Baldevbhai Patel 2017 15 SCC 1
[13] SEBI v Rakhi Trading Pvt Ltd 2018 SCC Online SC 101

2. Reg.4(2)(c) deals with inducing someone to subscribe to an issue. In order to bring further clarity and to ensure that the provision is not misused, the committee was of the opinion that the inducement should be fraudulent. The inclusion of word fraudulent would keep legitimate practices such as market-making out of the purview of this offence. Further, the earlier provision only included inducement by way of advancement of money but considering the changing market dynamics, the Committee deemed it fit to even include other mechanisms to induce subscription of shares.

3. Reg. 4(2)(d) deals with inducing someone to deal in securities with the objective of inflating, depressing, maintaining or causing fluctuation in price of a security by paying money. However, keeping in mind the changing market scenarios it would be unfair to limit the scope of this provision to inducement by paying/offering/promising money to a person. The committee deemed it fit to enhance the scope of this provision to include inducement by any mechanism including by paying/offering/promising money with the objective of artificially inflating, depressing, maintain or causing fluctuation in price of a security.

4. As regard Reg. 4(2)(e), the Committee was of the view that the provision is adequately broad and needs no changes. However, in order to bring more clarity in scope it was decided that an explanation may be added which would clarify that any act to fraudulently manipulate any reference price or bench mark price would also be covered under this provision. One such manipulation is also referred to as ‘marking the close’ in market parlance and would lead to impacting the settlement price for derivatives.

5. Reg. 4(2)(f) intends to cover publication of any false information. However, the Committee was of the opinion that the clause currently has a broad scope and in order to clarify the scope of the clause, the Committee was of the opinion that false information should be relating to securities such as information on financial results, financial statements, mergers and acquisitions, regulatory approvals etc.

6. Reg. 4(2)(h) deals with stolen or counterfeit securities and the Committee was of the opinion that the provision has become obsolete in the current form as the issue of counterfeit security is negligible after widespread adoption of dematerialization. However, the Committee is mindful of the fact that sometimes securities may be fraudulently issued and hence the provision may be amended to include dealing in fraudulently issued securities as well. However, in order to introduce a safeguard, a proviso is proposed to be included to protect the holder in due course as well as a person who purchased, in good faith, the securities which were previously traded on an exchange.

7. The Committee was of the view that considering the various reforms introduced by SEBI in regard to dissemination of information and legitimate business practices, Reg. 4(2)(i) 4(2)(j) and 4(2)(l) are obsolete and may be deleted.

8. Reg. 4(2)(k) deals with publication of a misleading advertisement. The Committee was of the view that the provision is too narrow in the present context given the use of technology and social media as mode of communication and information dissemination. The Committee was of the view that the provision must not be limited to 'advertisements' but must include information disseminated through any physical or digital means including internet which is designed to influence the decision of investors while dealing in securities.

9. Reg. 4(2)(m) at present deals with a situation wherein an intermediary doesn't disclose to the client transactions undertaken on its behalf. Considering the reports of unauthorized trading by brokers on behalf of their clients, the Committee is of view that the provision should be expanded. The provision must be made applicable to all market participants. Further, transaction undertaken in the name of a client without informing the client or taking instructions from client and mis-utilization or diversion of funds or securities of a client held in fiduciary capacity, it should be deemed to be fraudulent.

10. The present scope of Reg. 4(2)(n) is limited to circular trading by intermediaries with the purpose of increasing their commission (also known as 'churning') or to manipulate price of security. Since circular trading leading to manipulation in security is itself a fraud, the Committee is of the view that the provision should be extended to all persons dealing in a security and any circular transaction leading to manipulation in the price or volume of a security should be treated as fraud.

11. Reg. 4(2)(o) in its original form is limited to instances of encouragement of clients by intermediaries for trading in securities solely with intention of increasing brokerage or commission. This provision was inserted so as to avoid churning and ill advice by intermediaries especially brokers to the clients to trade more and more without any economic rationale and with a purpose to get more brokerage or commission since brokerage/commission is dependent on trading volume. However, this clause sometimes is too onerous on the market intermediary as certain genuine advice given by intermediaries may not lead to any profit for the client but result in higher brokerage/commission for the intermediaries. Hence, there is a need to segregate genuine advice/inducement for trading vis-a-vis fraudulent inducement. Further, it should be made applicable to all market participants rather than only on intermediaries. The committee is of the opinion that the provision should be revised to incorporate fraudulent inducement to trade by any market participant with the purpose of enhancing brokerage, commission or income.

12. On examining Reg. 4(2)(p), the Committee was of the opinion the provision should be expanded and made applicable to all market participants and further some more instances of documents/records may be provided in the provision.

13. The provision at Reg. 4(2)(q) currently makes any trading by an intermediary in advance of a substantial client order as fraud. In the wake of the judgment of Hon'ble

Supreme Court in the matter of *Kanaiyalal Patel v. SEBI*[14], wherein the ambit of front-running was increased from intermediary to any person, the Committee is of the opinion that if the trading is done by any person based on direct or indirect knowledge about an impending transaction by any person it should be treated a fraud. Further, the provision would cover trading in the security or its derivative. However, considering the fact that some intermediaries are legitimately aware of such information in advance, it was decided that protection may be given to trading which is based on information which is publicly available. Further, the Committee was of the view that the provision should not be construed to bring in the concept of front running one's own trades.

14. The provision at Regulation 4(2)(r) covers planting of any false or misleading news. In order to protect any inadvertent or genuine news coverage which subsequently turns out to be untrue, the Committee was of opinion that such acts when done knowingly should be considered to be fraud. Further, apart from news, planting of any information should be covered under the scope of this provision as news has limited connotation in view of multiple ways to disseminate information using new forms of media/ technology/communication. However, such planting of news or information would be deemed to be a fraud if it is done with an objective to impact the price/volume of a security.

15. The provision at Regulation 4(2)(s) was originally intended to cover mis-selling in mutual fund schemes and units. However, considering the wide scope of advisory services and the products available in the securities market, the Committee was of the view that knowingly mis-selling any securities or services in the securities market should be treated as fraud.

16. The Committee also considered the issue of front entities who lend their names or trading accounts, to others. Often such persons are not aware of the trading done in

[14] (2017) 15 SCC 1

their account and they become party to the fraud. Further, in absence of any evidence connecting these front entities to the main culprit, it becomes difficult to establish the fraud by the main culprit. In the context of use of such front entities to manipulate or carry out fraud, the Committee feels that if trading is being legitimately done by any entity, it should be in proportion to the entity's verifiable financial sources. Thus, trading done in excess of such verifiable financial sources should be deemed to be fraudulent if such trading leads to any manipulation in the price or volume of the security. There was considerable deliberation on the issue of what verifiable financial sources are and what would be included in the same. It was decided that SEBI would separately issue a circular prescribing the method for calculating verifiable financial sources and would specify the intermediary who would be monitoring trading in excess of the verifiable financial sources, after due consultation with market participants.

17. As per the current scheme of the regulation, in many instances, only the intermediaries are held responsible for any fraud. This gives scope to the promoters / directors / employees of these intermediaries to escape after indulging in fraudulent activity. While inserting new clauses, the Committee felt that the responsibility should be extended to intermediaries or entities registered under Section 12 of SEBI Act and also to employees working in these entities. Hence, the Committee was of the view that an explanation be added at the end of Reg. 4(2) explaining the ambit of term "Market Participant".

**The amendments to the PFUTP Regulations suggested on the above lines are placed at Annexure I.**

### 1.4. Financial Statements Fraud

Financial Statements / Reports are essential disclosures made by companies for informing the financial position and financial performance of the company to various stakeholders. Financial Statements / Reports include annual financial statements, quarterly financial results etc. The significance of accurate financial statements/reports for listed companies cannot be stressed enough since financial statements / reports of a

company influence the decision of the investors for buying, selling or dealing in the securities market.

Financial Statements Fraud involves the manipulation of books of accounts and other information used to prepare the financial statements which are commonly known as "cooking of books of accounts" with intent to report a false and misleading financial position and financial performance of the company. While a material misstatement of financial statements can be a result of an error or fraud, in the case of the latter, it is an intentional act that results in such misstatements. There are two types of misstatements arising as a result of fraud — misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets. The Committee notes that financial statement frauds are generally done in a listed company to manipulate the share prices of listed companies or to hide diversion, misutilization or siphoning off funds and resources of the company.

Financial Statement fraud may be accomplished by (i) manipulation, falsification, or alteration of books of accounts or supporting documents from which financial statements are prepared; (ii) misrepresentation in or intentional omission from the financial statements of events, transactions, or other significant information; or (iii) Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

The Committee noted that the cases related to "Financial Statement Frauds" in respect of listed companies are dealt in two parts

1. Fraud perpetrated by manipulating books of accounts and financial statements to manipulate the share prices of listed companies or to hide diversion, misutilization or siphoning off funds and resources of the company; and
2. Misleading disclosures made by a company by disclosing manipulated financial statement / financial results / statement of utilization of issue proceeds because disclosures are based on books of accounts/ information which are manipulated.

In respect of the latter type of financial statement fraud, the Committee noted that SEBI has, in many cases, charged the company and directors of the company who were

responsible for making such misleading disclosures under regulations 4(2) (f), (k) (r) of the PFUTP Regulations. However, even in such cases there are limited allegations of misleading disclosures made by company by publishing manipulated financial statement / financial results / statement of utilization of issue proceeds etc. Further, in most cases, the enforcement actions are taken against the company and the directors of the company who were responsible for making such disclosures, rather than against persons who have manipulated the books of accounts and financial statements etc.

In respect of the first part of financial statement fraud as stated above, it is noted that there are only a few cases where SEBI has charged persons for committing fraud of manipulating books of accounts to manipulate the share prices of listed companies or to hide diversion, misutilization or siphoning off funds and resources of the company.

The Committee noted that Ministry of Corporate Affairs (MCA) has power under the Companies Act, 2013 to take action against persons responsible for fraud committed by manipulating books of accounts. The requirement of keeping books of accounts and financial statements for every financial year which give a true and fair view of the state of the affairs of the company flow from the chapter IX of the Companies Act, 2013. Accordingly, any manipulation in the books of accounts to manipulate the share prices of listed companies or to hide diversion, misutilization or siphoning off fund and resources of the company results in violation of the Companies Act and the persons responsible for such manipulation are usually charged under the Companies Act.

The Companies Act is applicable to all companies whether listed or unlisted, public and private. However, the manipulation of books of accounts and financial statements have very high degree of implication for listed companies rather than for unlisted companies as far as investor interest is concerned.

Generally, promoters, senior management (MD, CEO, CFO etc.) and auditors are found to be involved in these frauds. The victims of these frauds are usually investors/ shareholders of the listed company. They lose the value of their investments, especially when share prices fall after the frauds are discovered. The offender is not the company itself, but some of the people within the company or in the management of the company. Discovery of the frauds often results in total downfall of the company due to loss of

business, reputation, customers etc. Many mid-sized companies may go into liquidation after such fraud.

Financial statement frauds appear to be less in number in the securities market but the impact of these frauds is generally very heavy. Globally, financial statements frauds in the listed company have resulted in loss of confidence by domestic and international investors in not only that listed company but also the entire industry which that listed company belongs to. Some of the big financial statement frauds includes Enron, WorldCom, etc. Indian securities markets also have witnessed financial statement frauds in listed companies. One of the biggest frauds in the Indian securities market was in the financial statements of Satyam Computers Ltd.

While in the case of securities market abuse like market manipulation or insider trading, investors who traded during the period of the manipulation get adversely affected, financial statement fraud affects all investors who have invested in the shares of that listed company whether they traded during the period of the manipulation or not.

As noted earlier, the Supreme Court in ***N Narayanan v Adjudicating Officer, SEBI***[15] observed that market abuse / manipulation "*can be achieved by inflating the company's revenue, profits, security deposits and receivables, resulting in price rise of the scrip of the company. Investors are then lured to make their "investment decisions" on those manipulated inflated results, using the above devices which will amount to market abuse."*

The Committee deliberated that SEBI, as a regulator of the securities market, has a duty to protect the interest of investors from such financial statement frauds.

SEBI's current jurisdiction on companies finds its source in Section 24 (1) of the Companies Act 2013. Section 24 (1) limits the jurisdiction of SEBI to matters covered under Chapters III and Chapter IV and Section 127 of the Companies Act, 2013 insofar as they relate to issue and transfer of securities and non-payment of dividend by listed companies or companies intending to get their securities listed. As specified in Section 24(2), SEBI's jurisdiction is to be exercised in line with the powers conferred upon SEBI

[15] 2013 12 SCC 152

under the SEBI Act, 1992[16]. The Committee also notes that SEBI's jurisdiction to take steps in the interests of investors is not curtailed by the jurisdiction of other statutory authorities.

The Supreme Court in *SEBI v Pan Asia Advisors Ltd and Anr*[17] was faced with the question of whether SEBI had jurisdiction in a case where Lead Managers to Global Depository Receipts ("**GDRs**") issued outside India colluded with the companies by issuing a large number of GDRs, and giving a false respectable appearance to the financial statement of the issuing companies while in reality, by making a few entries, it was shown as through a large surge in the capital of the issuing companies. The initial investors to GDRs were also found to be fictitious, and meant to lure Indian investors to invest at a higher share value of the issuing companies at a later stage, upon GDRs being converted into shares. The Supreme Court held that SEBI's jurisdiction is not curtailed by jurisdiction that may be exercised by RBI or under FEMA:

*"We are therefore convinced that having regard to the nature of allegations in the interests of the investors in securities as well as the statutory obligation/duty cast upon SEBI to protect their interests, ….. That apart under Section 11(3) it is provided that SEBI can exercise its powers under sub-section (2)(i) or (i-a) or sub-section (2-A) notwithstanding anything contained in any other law for the time being in force, meaning thereby, the action that can be taken for any of the violation under FEMA or RBI Act, SEBI can validly exercise its powers under the SEBI Act, 1992.."*

The Supreme Court also held - *"A perusal of the above details which are required to be furnished statutorily, shows that in the event of any wrong statement furnished in the above referred to forms, it provides scope for proceeding against the issuing company as well as any person connected with such violation and it would certainly empower the*

[16] SEBI's powers under the SEBI Act are set out in Sections 11 to 11D. These powers include, under Section 11(2) of the Act, calling for information and records under Section 11(2)(ia) of the SEBI Act, undertaking inspection of any book, register or other record of any listed public company or a public company intending to get its securities listed on any stock exchange under Section 11(2A) of the SEBI Act.

[17] 2015 14 SCC 71

*authority viz. SEBI to initiate action under the SEBI Act, 1992 in order to protect the interests of the Indian investors in securities and the security market."*

The question whether SEBI has jurisdiction to issue show cause notices to Chartered Accountants in connection with the work they had undertaken for a listed company in the matter of maintaining accounts and balance sheets was also considered by the Bombay High Court in ***Price Waterhouse & Co v SEBI***[18]. In that case, it was held that SEBI, under Section 11 of the SEBI Act, had power to prohibit fraudulent and unfair trade practices and was empowered to pass appropriate orders to safeguard the interest of investors or the securities market. SEBI was held to have had the power to take remedial or preventive measures against a Chartered Accountant if there was material against him to the effect that he was instrumental in preparing false and fabricated accounts.

The SEBI Act is to be read in harmony with the provisions of the Companies Act, 1956. Both Acts are to work in tandem, in the interest of investors.[19] SEBI had power to administer select provisions of the Companies Act as was set out in Section 55A of the Companies Act, 1956, which has since been replaced by Section 24 of the Companies Act, 2013. Although the Ministry of Corporate Affairs ("MCA") has powers and duty to take action for financial statement frauds under the Companies Act, SEBI shall concurrently take action against the persons who engage in fraud by manipulating books of accounts/ financial statements to manipulate the price of listed securities and hide siphoning / diversion / misutilization of funds.

The Committee noted that SEBI has powers under section 11B of the SEBI Act, 1992 to issue various directions including direction to bar person involved in financial statement fraud from associating with listed companies as promoter / director / auditor of any listed company, impounding and disgorgement of any illegal gain made by such person etc.

[18] 2011 2 Bom CR 173
[19] Sahara India Real Estate Corpn Ltd v SEBI 2013 1 SCC 1

The Committee noted that such powers are generally not with available with MCA under the Companies Act, 2013.

In view of above, the Committee felt that there is a need for SEBI to take direct action against perpetrators of financial fraud as such fraud has an adverse impact on not only the shareholders of the company but also impacts the confidence of investors in the securities markets. While the primary responsibility of monitoring/ supervision of books of accounts of companies is with MCA under the Companies Act, in respect of listed companies SEBI should also take action for fraud committed by manipulating books of accounts and/ or financial statements to directly or indirectly manipulate the share price of a listed company or hide diversion, misutilization or siphoning off public issue proceeds / assets / earnings of a listed company. The Committee also examined the power of SEBI to inspect books of accounts and records of a listed company.

Section 11(2A) of the SEBI Act lays down the specific power of SEBI to conduct inspection of books of account of a listed company in case it has reasonable grounds to believe that the company has been indulging in Insider Trading or Fraudulent and unfair trade practices. The Committee noted that the listed companies have to comply with various Regulations framed under SEBI Act such as ICDR Regulation, LODR Regulations, etc. The Committee was of the view that SEBI should have power to conduct inspections of books of accounts of a listed company for contravention of any securities laws without limiting it to insider trading or fraudulent or unfair trade practices.

**Recommendation**

1. The committee recommends that section 12A of the SEBI Act, 1992 which prohibits manipulative and deceptive devices, insider trading and substantial acquisition of securities or control should be amended to include a new subsection which would clarify further SEBI's existing powers to take steps for misstatement of financial statements and / or misutilisation of issue proceeds etc. The additional sub-section may read as under:

   12A. No person shall directly or indirectly -

(g) employ or assist in employing any device, scheme or artifice to manipulate the books of accounts or financial statement of a listed company to directly or indirectly manipulate the price of listed securities or hide the diversion, misutilization or siphoning off public issue proceeds or assets or earnings of a listed company or company proposed to be listed.

Further, the Committee recommends that regulation 3 of the PFUTP Regulations may also be amended in line with aforesaid amendment proposed to the SEBI Act, 1992.

The Committee mentioned that abovementioned amendments would be in the nature of clarification regarding powers already available with SEBI, under which action has been taken for misstatement of financial statements and / or misutilisation of issue proceeds etc.

2. With regard to SEBIs power to inspect books of accounts of listed companies, Section 11 (2A) of SEBI Act states that

Without prejudice to the provisions contained in sub-section (2), the Board may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in section 12) which intends to get its securities listed on any recognised stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

The Committee recommends that the words "*has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market*" in the aforesaid section should be replaced with "*is involved in violation of Securities Laws*".

**The amendments to the SEBI Act, 1992 suggested on the above lines are placed at Annexure IV.**

## CHAPTER 2 | INSIDER TRADING

'Insider Trading' is the unlawful act of trading in securities while having access to unpublished information which, if published, could have impacted the price of the securities being traded in the market. Insider trading has been the subject of much regulation world-wide and in the Indian context, SEBI has promulgated the SEBI (Prohibition of Insider Trading) Regulations, 1992, which were reviewed by a High Level Committee under the chairmanship of Justice N. K. Sodhi which culminated in the SEBI (Prohibition of Insider Trading) Regulations, 2015.

The Committee noted that, the number of cases of insider trading are few and far between. One of the reasons for this is the challenge faced in investigating and establishing cases of insider trading. While SEBI has strengthened its Insider Trading Regulations fairly recently, the challenges relating to investigation and gathering of evidence in such cases still remain.

One of the issues considered by the Committee was the necessity of having separate regulations to deal with Insider Trading which is also considered to be a kind of fraud. The Committee noted that because of the peculiar challenges related to cases involving establishment of insider trading allegations, the burden of proof is structured differently in the Insider Trading Regulations vis-à-vis the PFUTP Regulations. The Insider Trading Regulations place the burden of proof on the insider to show that he/she did not trade while in possession of inside information ("unpublished price sensitive information" or "**UPSI**"). On the other hand, under the PFUTP Regulations, the burden of proof is on SEBI to show that the manipulation took place.

The Committee also examined the structure of insider trading regulations in various jurisdictions, and upon deliberation, agreed that the existing regime of separate regulations for insider trading and fraud / unfair trade practices was justified.

Considering the challenges faced by SEBI during investigation of insider trading cases, the Committee went into some detail to strengthen the ability of SEBI to carry out effective investigations, as brought out in the next chapter.

The Committee also deliberated on some of the challenges faced by market participants in interpreting the Insider Trading regulations such as the kind of information which can be shared for legitimate purposes, procedures involved in sharing information for the purpose of due diligence etc.

The following paragraphs deal first with recommendations relating to SEBI Act followed by recommendations relating to PIT Regulations in the chronology of the Regulations which start with definitions in Regulation 2, restrictions on communication of unpublished price sensitive information in regulation 3, and prohibition on insider trading in Regulation 4.

### 2.1. Aligning the SEBI Act on Insider Trading

Insider Trading is prohibited under Section 12A of the SEBI Act which states that "*no person shall engage directly or indirectly in insider trading or deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person in a manner which is in contravention of the provisions of the Act or regulations made thereunder*. "

The penalty for insider trading is prescribed under Section 15 G of SEBI Act which states that any insider who,—

"*either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information; or communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or*

*counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price-sensitive information,*

*shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher*".

Section 15G (i) mentions dealing in securities on the basis of unpublished price sensitive information whereas Section 12 A mentions dealing in securities while in possession of unpublished price sensitive information.

There was a need to align the two sections so that they refer to the same action i.e. dealing in securities while in possession of unpublished price sensitive information.

**Recommendation:**

The Committee recommends that Section 15G of SEBI Act, 1992 needs to be aligned with Section 12 A of the Act and the PIT Regulations.

**The amendments to the SEBI Act, 1992 suggested on the above lines are placed at Annexure IV.**

### 2.2. Definitions under the Insider Trading Regulations

Regulation 2 of the PIT Regulations defines various terms used in the Regulations. The Committee noted that there is need for some clarity on some of the definitions such as those relating to qualifications of compliance officer, when a company can be considered as proposed to be listed and need for consequential changes to definition of unpublished price sensitive information after notification of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**LODR Regulations**").

**Recommendations:**

The definition of "compliance officer" under regulation 2(1)(c) of the Insider Trading Regulations, stipulates, *inter alia*, that such compliance officer is required to be "financially literate" as a prerequisite. While the term "financially literate" has not been defined in the PIT Regulations, the Committee noted that the said term is explained under the LODR Regulations.[20] Accordingly, the Committee recommends to adopt the definition of "Financially Literate" in the LODR Regulations for the purpose of the Insider Trading Regulations.

[20] Explanation (1) to Reg. 18(1)

The Insider Trading Regulations apply to securities that are listed and "proposed to be listed". However, the Insider Trading Regulations do not clearly state what "proposed to be listed" entails. In the absence of clarity, the phrase "proposed to be listed" could have different interpretations and may include the securities of a company from the time commencing from the date of: (a) board resolution approving the IPO; (b) appointment of merchant bankers; and (c) filing the draft red herring prospectus or red herring prospectus with SEBI. Further, since the definition of UPSI under the Insider Trading Regulations is linked to information which on becoming generally available would affect the market price of securities, it is pertinent to determine the point in time when information relating to a company, which proposes to achieve listing, will be regarded as UPSI. It was noted that prior to filing of the draft red herring prospectus with SEBI, it is difficult to state with certainty that there is any concrete intention for a company to get listed on the stock exchange(s).

In view of the above, the Committee recommends that the term "Proposed to be listed" be defined as follows:-

"Proposed to be listed" shall refer to such unlisted company which has filed offer documents or other documents, in connection with listing, with SEBI, stock exchange(s) or registrar of companies and the securities of such company are not yet listed; or such unlisted company which has filed a draft scheme of arrangement under the Companies Act 2013, with the stock exchanges for obtaining observations or no-objection confirmations under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and the securities of such company are not yet listed.

The definition of "unpublished price sensitive information" (UPSI) under regulation 2(1)(n) of the Insider Trading Regulations is an inclusive definition and currently "material events in accordance with the listing agreement" are deemed to be UPSI. The Committee noted that the provision related to "material events" as stated in Regulation 68 of LODR Regulations is as follows:

"*Disclosure of material events or information.*
*The listed entity shall promptly inform to the stock exchange(s) of all events which are*

*material, all information which is price sensitive and/or have bearing on performance/operation of the listed entity."*

The Committee noted that the aforesaid regulation require disclosures of material events or information which may or may not be price sensitive. Accordingly, the Committee is of the view that all material events which are required to be disclosed as per the Regulation 68 of the LODR Regulations may not necessarily be UPSI under the PIT Regulations. Since, the definition of UPSI is inclusive, the Committee recommends the removal of explicit inclusion of "material events in accordance with the listing agreement" in definition of UPSI.

### 2.3. Communication or procurement of unpublished price sensitive information

**Communication / procurement is in furtherance of legitimate purposes**

Regulation 3 of the PIT Regulations prohibits the communication and procurement of unpublished price sensitive information, unless such communication / procurement is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations[21].

The Committee noted that the term legitimate purpose is not defined under PIT Regulation and is open to various interpretations (strict or expansive)[22]. However, entities are expected to develop practices / policies for responsible treatment of unpublished price sensitive information.

The Committee after deliberation noted that legitimacy of any action under which UPSI is communicated / procured remains largely subjective and can only be determined after

[21] Insider Trading Regulations, regulations 3(1) and 3(2)

[22] "*Considering the settled principles of interpretation, Regulation 3 must be interpreted bearing in mind the basic underlying assumption and the intent of the legislature in introducing such Regulations. The Regulations was never intended as an all purpose ban on trading. Legitimate transactions undertaking to achieve a corporate purpose or to discharge a fiduciary duty or in the interest of a body of public shareholders or stakeholders in a company or transactions in the public interest or transactions undertaken without an intent to make profit or to gain unlawfully or without a view to misuse information, or the like, would not be hit by the prohibition contained in the Regulations. The whole function of the Regulation is to regulate, not to stop transactions from taking place. Any other interpretation will lead to the stifling genuine transactions undertaken for legitimate corporate purpose or the like. It is submitted that the whole Regulation is an anti-fraud regulation." Rakesh Agrawal v SEBI* [2003] SCC OnLine SAT 38: [2003] SAT 6 [34]

having examined circumstances under which the information was dealt. The Committee is of the opinion that it may be difficult to unequivocally define such term, whether by way of an inclusive definition or otherwise.

Once UPSI is shared for legitimate purposes, the company loses control over further use of that information by those who come into its possession. If such information is misused for insider trading, it becomes difficult to establish a connection between the company and the recipient of information. It would thus be prudent to have a physical and/or digital trail of information flows of such legitimately shared information. It would also be prudent to intimate the persons receiving the UPSI of their obligation towards preventing mis-use of such information for insider trading, by way of an advance notice.

In a recent case[23] on insider trading decided by the SAT, the SAT observed the following

*"Before parting, we would like to bring it to the notice of SEBI that the question as to whether investors participating in the market gauging exercise should be allowed to trade in all segments of the market prior to the issue opens needs to be looked into."*

This order specifically refers to the exercise of market gauging and raises the issue of whether trading can be done on the basis of information shared under market gauging. The Committee felt that intimation by serving noticee to or by entering into a confidentiality/ non-disclosure agreement with persons receiving UPSI would also address any possible sharing of UPSI in market gauging.

**Recommendation**:

In view of the above, the Committee recommends that regulation 3(2) may be amended to mandate to the board of directors of the listed company or intermediaries to define their own policy / definition relating to "legitimate purposes" (albeit, within the contours provided under law). This will give freedom to the listed company / market participants (while at same time ensuring responsibility since the directors would be required to justify the policy / definition) to decide what may or may not be "legitimate purposes" based on its business

[23] Factorial Master Fund v. SEBI, Decided on June 29, 2018

/ industry related needs.

Further, in order to give some illustrations of legitimate purpose, an explanation may be included as under:

Sharing of unpublished price sensitive information by any person with partners, collaborators, lenders, major customers, major suppliers, investment bankers, legal advisors, auditors, insolvency professionals or other advisors or consultants is considered to be for "legitimate purpose", subject to such sharing not being carried out to evade or circumvent the prohibitions of these regulations;

The listed company / market participant should be required to maintain an electronic record containing name of person with whom UPSI is shared and the nature of UPSI. Further, while sharing UPSI for "legitimate purpose", the listed company / market participant should serve a notice on, or sign a confidentiality/ non-disclosure agreement with, the person with whom UPSI is shared, informing him/her that he has to ensure the compliance of the PIT Regulations while in possession of UPSI shared with him/her.

**Information sharing during due diligence:**

Regulation 3(3) of the Insider Trading Regulations allows communication / procurement of UPSI for purposes of facilitating due diligence exercises involved in transactions which (a) trigger an open offer and (b) do not trigger an open offer.

The Committee noted based on the feedback from listed companies and market participants that currently the board of directors of the target listed company is required to be of the informed opinion that any such proposed transaction is in the best interests of such target listed company, before allowing the UPSI relating to such target listed company to be communicated / procured. From a practical viewpoint, due diligence exercises are generally carried out at a very preliminary / nascent stage of the transaction with a view to determine the viability of the proposed transaction. The Committee noted that at such preliminary / nascent stage, it is not only difficult but also impractical for the board of directors to gauge, evaluate and form an opinion as to whether the proposed transaction is in the best interests of the target listed company.

**Recommendation**:

After deliberation, the Committee agreed that in such cases it may not be possible for the board of directors of the target listed company to opine, at the time when due diligence exercises are being conducted, that any such proposed transaction is in the best interests of such target listed company. However, the Committee felt that the board of directors may at least evaluate and opine on whether the sharing of the UPSI for due diligence is in the best interests of the company. Accordingly, the Committee recommends necessary amendment in the regulation 3(3)(i) and (ii).

Such UPSI which is shared is also required 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.[24] The Committee recommends that the information which is made generally available prior to transaction should be adequate and fair to cover all relevant and material facts.

## 2.4. Defences under the Insider Trading Regulations

Regulation 4 of the PIT Regulations prohibits trading by insiders while in possession of UPSI. However, the regulation allows the insider to prove his innocence by demonstrating certain circumstances. These constitute limited defences which an insider charged with insider trading may rely on to prove his / her innocence.

In this regard, the Committee deliberated on the adequacy of the defences and whether any legitimate transactions are getting covered in the ambit of insider trading such as exercise of employee stock options[25], trades by 'individual insiders' other than promoters who may transact while being in possession of the same UPSI.

A need was expressed before the Committee to take into account some of the defences adopted by overseas jurisdictions and counter-balance the wide import of the Insider

[24] Regulation 3 (3) (ii) of the PIT Regulations.
[25] Discussed by SEBI in its PIT Guidance Note (query 1)

Trading Regulations with clear, certain and reasonable defences to the charge of insider trading, in light of the severe penalties and reputational consequences of being held in violation of the Insider Trading Regulations.

The Committee also considered whether the principle of strict accountability, currently set out as a legislative note to regulation 4(1) of the Insider Trading Regulations, may be read as subservient to the main regulations, thereby potentially diluting its regulatory sanctity.

The legislative note indicates that the burden of proof is on the insider to prove his innocence pursuant to the defence(s) under the regulation 4(1) of the Insider Trading Regulations. However, since legislative notes may generally be read as subservient to the main regulations, the enunciation of the strict accountability principle as part of the said regulation may, enhance the regulatory sanctity of the principle.

**Recommendations**:

The Committee recommends that the circumstances mentioned as defences under regulation 4(1) of the Insider Trading Regulations be amended / supplemented (while retaining its inclusive ambit) to include the following:

a) Defence available for off-market *inter-se* transfer between promoters, who were in possession of the same UPSI, may be extended to non- promoters also provided that the possession of UPSI is not as a result of information shared under Regulation 3 (3) of the PIT Regulations.
b) New circumstance may be included for transaction carried out through the block deal window mechanism among persons possessing the same UPSI.
c) New circumstance may be included for the transaction carried out in a *bona fide* manner pursuant to a statutory or regulatory obligation to carry out such transaction such as to achieve Minimum Public Shareholding Requirements as per the Securities Contracts (Regulation) Rules, 1957.
d) New circumstance may be included for the transaction undertaken pursuant to the exercise of stock options in respect of which the exercise price was pre-determined in compliance with applicable regulations.

Further, the principle presently enunciated in the legislative note to regulation 4(1) of the Insider Trading Regulations may be expressly stipulated as a proviso to regulation 4(1), further clarifying that the burden of proof of innocence would be on the person charged as being an insider in violation of regulation 4 of the Insider Trading Regulations.

## 2.5. Trading Plans

As per Regulation 5 of the PIT Regulations, an insider is entitled to formulate a trading plan, pursuant to which trades may be carried out on his behalf.[26] The trading plan **(i)** is required to cover a period of at least 12 (twelve) months; **(ii)** is required to be disclosed to the stock exchanges prior to its implementation (ie, actual trading); **(iii)** can be executed only after 6 (six) months from its public disclosure; **(iv)** is irrevocable; and **(v)** cannot be deviated from once publicly disclosed.[27]

Thus, on the face of it, the implementation of a trading plan may end up being detrimental to the insider. Such restrictions (coupled with the premature price movement issue), can lead to a scenario where the insider is forced to trade even if such insider is put in an economically disadvantageous position owing to vagaries such as change in market conditions and regulatory regime, investors dealing in shares of the listed company ahead of the actual implementation of the plan (discussed above), etc. Given these issues, trading plans under the Insider Trading Regulations have remained unpopular.

Further, the disclosure to the stock exchanges and consequentially the public, can potentially (and in all likelihood) impact the price movement of the listed company's shares, as investors becoming privy to the publicly disclosed trading plan could start dealing in such shares, ahead of the actual implementation of the trading plan.

It is also pertinent to note that trading plans were proposed under the Sodhi Committee Report on an experimental basis. The discussion under the Sodhi Committee Report explicitly stated that "*…it would be in the fitness of things for India to test the concept of a "trading plan" that would enable compliant trading by insiders…*". The Sodhi Committee

[26] Insider Trading Regulations, regulations 5(1)

[27] Insider Trading Regulations, regulations 5 (1), 5(2), 5(4) and 5(5)

Report further stated that "*…upon review of empirical evidence and feedback after the concept is introduced, it would always be open to SEBI to dilute or enhance the regulatory conditions attached to trading plans under the Proposed Regulations.*" The Sodhi Committee Report also mentioned that some of its Committee members were of the view that trading plans should not be disclosed to the stock exchange(s) at all, while another view was that trading plans may be disclosed to the stock exchange(s) if the value of trades envisaged in the trading plan is beyond a certain threshold.

**Recommendations:**

Promoters and perpetual insiders such as chief executive officers (CEOs), chief financial officers (CFOs) and active directors may not be able to modify / revoke their trading plans once submitted considering that they are always likely to be in possession of UPSI (in addition to not being able to implement trades envisaged under a trading plan while in possession of UPSI under the current Regulations). This may be against their interests. Trading plans may, thus, continue to remain unpopular as far as promoters and perpetual insiders are concerned.

The Committee could not arrive at a consensus on this issue and thus agreed to continue with the current provisions. However, the Committee recommends the following clarifications with regard to those who file a trading plan:

a. Pre-clearance of trade may not be required in case trading plan has been filed and approved.
b. Adherence to trading window norms and restrictions on contra trade may not be applicable for trading done in accordance with the approved trading plan.

**The amendments to the PIT Regulations suggested on the above lines are placed at Annexure II.**

## CHAPTER 3 | THE CODE OF CONDUCT UNDER INSIDER TRADING REGULATIONS

The “PIT Regulations” or the “Insider Trading Regulations” prescribe certain codes to be followed by listed companies, market intermediaries and other entities. The Code of Fair Disclosure specified in Regulation 8 of the PIT Regulations deals with the practices and procedures to be followed by listed companies for ensuring fair disclosure of unpublished price sensitive information. The Code of Conduct specified in Regulation 9 is applicable to listed companies, SEBI-registered market intermediaries and other entities for regulating, monitoring and reporting trading by their employees and others.

The Committee noted that SEBI-registered intermediaries are also required to follow Codes of Conduct under the respective regulations governing their activities. For instance mutual funds are registered under the SEBI (Mutual Funds) Regulations, 1996 (“**MF Regulations**”) and are required to follow the Code of Conduct laid down for mutual funds in the said regulations. Similarly, brokers are registered under the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 (“**Broker Regulations**”) and are required to follow the code of conduct laid down under these regulations. This leads to multiplicity of Codes of Conduct to be followed by market intermediaries.

The Committee explored whether it was possible to reduce multiplicity of Codes of Conduct in various Regulations and consolidate them so as to better delineate the responsibilities for compliance. The Committee also examined the necessity of further refinements in Code(s) of Conduct for improving transparency and better compliance.

The Committee noted that the Codes of Conduct specified in the respective Regulations governing the activity of a market intermediary fulfilled a different purpose and laid down conduct requirements which were specific to the role of the market intermediary, such as the fiduciary responsibility of an intermediary towards clients, maintaining high standards of fairness and integrity in their business etc. On the other hand, the Code of Conduct prescribed in the PIT Regulations dealt specifically with regulating trading in securities by persons who could have access to unpublished price sensitive information. Thus, the different codes of conduct had different roles and it would be prudent to retain them separately.

The Committee reviewed the Code of Conduct and the Code of Fair Disclosure under the PIT Regulations from the perspective of bringing more clarity as well as making suggestions to have better prevention of insider trading. The Code of Conduct which regulates trading in securities is a means to ensuring that persons who have access to UPSI are aware of their responsibility to not trade in securities while in possession of UPSI. Hence, the codes provide for trading windows when such persons can trade, and require reporting of trades carried out. The Committee also considered enhancing reporting requirements to help ease the challenges faced in investigating cases of insider trading.

### 3.1. Separate Code of Conduct for Listed Companies, Market Intermediaries and other entities

The PIT Regulations currently specify a common Code of Conduct applicable to listed companies, intermediaries and other persons who are required to handle UPSI during the course of their business operations, such as auditors, accountancy firms, law firms, analysts and consultants. From a practical viewpoint, all provisions of the Code of Conduct may not be applicable equally to listed companies, intermediaries and other entities like auditors, law firms etc.

For instance, the requirement of trading window in which employees can trade in the company stock is applicable only to listed companies. This is not applicable for intermediaries which may have access to UPSI related to multiple companies with which they have business dealings. Thus, intermediaries are required to use grey lists or restricted lists of securities in which trading is restricted.

For the purpose of convenience, a common term, “fiduciaries” may be used in the regulations for referring to other persons who are required to handle UPSI during the course of their business operations, such as auditors, accountancy firms, law firms, analysts and consultants.

**Recommendation**

In order to bring clarity on the requirements applicable to listed companies and others, the Committee recommends that the PIT Regulations may be amended to prescribe two separate Codes of Conduct prescribing minimum standards for (1) Listed companies and (2) Other Persons who are required to handle UPSI during the course of their business operations such as Market Intermediaries and fiduciaries which include auditors, accountancy firms, law firms, consultants etc.

**The suggested draft codes of conduct are placed at Annexure III.**

### 3.2. Applicability of code of conduct

As stated above, Regulation 9 of the PIT Regulations deals with the code of conduct for regulating and monitoring trades by employees and other connected persons. The regulations implies that the code of conduct is to be followed by all employees. However, the Code of Conduct itself which is contained in Schedule B (**Clause 3**) of the PIT Regulations states that only employees and connected persons designated on the basis of their functional role in the organisation shall be governed by the Code of Conduct. This can result in confusion as to the coverage of the Code of Conduct. Further, a listed company or market intermediary cannot enforce the code on persons other than employees and their relatives. Including all connected persons under coverage of the code may be impractical, considering the wide definition of connected persons.

**Recommendation**

The Committee recommends that the code of conduct may be made applicable to "designated person(s)" and immediate relatives of the "designated person(s)" only. The term "designated person(s)" should be defined by means of an explanation to regulation 9(2).

"Designated person(s)" for listed company should at least include Promoter, CEO and upto two levels below CEO of such listed company and its material subsidiaries irrespective of their functional role in the company or ability to have access to UPSI. "Designated person" should also include any other employees, of such listed company

and its material subsidiaries and associate company (s) who are designated on the basis of their functional role as having access to UPSI or otherwise have access to UPSI.

"Designated person(s)" for intermediaries and other entities such as auditors, advisors, law firms etc. should at least include Promoter (only individual and Investment companies), CEO and upto two levels below CEO of such intermediary or entities. "Designated person" should also include any other employees, of such intermediaries and other person who are designated on the basis of their functional role as having access to UPSI or otherwise have access to UPSI.

The board of directors or such other analogous authority in consultation with the compliance officer should specify the designated persons to be covered by the code of conduct on the basis of their role and function in the organisation and the access that such role and function would provide to unpublished price sensitive information irrespective of seniority and professional designation.

Temporary employees and support staff, such as IT staff or secretarial staff, should also be covered as "Designated person(s)", on the basis of their ability to access the UPSI.

### 3.3. Disclosures of trades

The Committee noted based on the feedback from listed companies and market participants that Regulation 7(2) of the Insider Trading Regulations requires every promoter, employee and director to make disclosures to the listed company (and onward by the listed company to the stock exchange(s)) if thresholds therein are met. Such requirement results in every employee of the listed company (including those who cannot be expected to be in possession of UPSI based on their role / function) to make disclosures under this regulation. This puts undue burden on the listed company, its employee and compliance officers, particularly where the company has hundreds or thousands of employees.

**Recommendation**

The Committee recommends that the regulation 7 may be suitably amended to restrict applicability of these regulation to promoters, directors and designated persons only. (As

per the new definition promoter, CEO and two levels below CEO will be covered under designated person)

### 3.4. Institutional Responsibility for Insider Trading

While the PIT Regulations provide for a preventive mechanism through the code of conduct and fair disclosure, sometimes, in the absence of proper implementation of the Codes, insider trading can take place.

To have better implementation of preventive measures prescribed under the PIT Regulations, there is need to have a mechanism for institutional responsibility to prevent insider trading. The regulations should clearly specify the persons who would be held responsible in the event of failure to properly implement the preventive measures i.e. failure to formulate an effective code of conduct and put in place an adequate and effective system of internal control to ensure proper implementation of various requirements given in the PIT Regulations to prevent insider trading.

**Recommendations**

The Committee recommends that a new regulation may be added to PIT Regulations to include the following requirements:

The Chief Executive Officer / Managing Director of a listed company /market intermediary shall formulate a code of conduct and put in place an effective system of internal controls to ensure compliance with the requirements given in the SEBI (PIT) Regulation to prevent insider trading. These requirements shall include ensuring the following:

1. All the unpublished price sensitive information is identified and its confidentiality maintained as per the requirements of the PIT Regulations
2. All employees who have access to UPSI are identified as designated employee.
3. Adequate restrictions are placed on communication or procurement of unpublished price sensitive information as required by the PIT Regulations
4. Lists of all employees and other person with whom UPSI is shared are maintained and confidentiality agreements is signed or Notice is served to all such employees and persons
5. Compliance with all other relevant requirements specified under the PIT Regulations.

6. Periodic process review to evaluate effectiveness of such internal controls.

The board of directors of every listed company and the board of directors or head(s) of the organisation of market intermediary and fiduciaries. should ensure the Chief Executive Officer / Managing Director comply with aforesaid requirement to formulate the code of conduct and put in place an effective system of internal control.

Every listed company, market intermediary and fiduciaries should identify and designate a compliance officer to administer the code of conduct and implement system of internal checks and control under the PIT Regulations.

The Audit Committee of a listed company or other analogous body for market intermediary or other entity should review compliance with provisions of the PIT Regulations. Further, they should check that the systems for internal control are adequate and are operating effectively, at least once in a year.

The Committee recommends that intermediaries should also have a similar preventive mechanism to prevent frauds or market abuse such as front running, miss-selling, unauthorised trading etc. The respective codes of conduct of intermediaries cast a responsibility on the intermediary to ensure integrity and fair conduct and avoid malpractices and manipulative practices in their area of operation. Intermediaries need to put in place an adequate and effective system of internal controls to ensure that the conduct requirements in their respective codes of conduct are properly implemented, particularly in the context of manipulation and fraudulent trading. The Chief Executive Officer / Managing Director of market intermediary should be responsible for putting in place adequate and effective system of internal control and the compliance officer should administer the internal controls to prevent manipulation and fraudulent trade practices. SEBI may consider issuing appropriate circular with regard to institutional responsibility as outlined in this para.

### 3.5. Inquiries by Listed Companies in case of suspected leak of UPSI

The Committee noted recent cases of leak of UPSI related to listed companies on Whatsapp messages. Such information originates from within the company and affects the listed company in terms of its market price as well as loss of reputation and investors'

/ financers' confidence in the company. Leakage of UPSI from a company is a matter of serious concern not only for the regulator but for the company as well, and listed companies should take responsibility to find out sources responsible for the leakage and plug loopholes in the internal control systems to prohibit reoccurrence of such leakage of UPSI.

**Recommendations**

The Committee recommends that the PIT Regulations should place the following mandate on listed companies:

Listed Companies should initiate inquiry in case of leak of UPSI or suspected leak of UPSI and inform SEBI promptly. The listed company should have written policies and procedures for this inquiry approved by Board of Directors of the company.

Market Intermediaries and other person/ entities who have access to UPSI should co-operate with the listed company for inquiry conducted by listed company for leak of such UPSI.

The listed company should also have whistle-blower policies that make it easy for employees to report instances of leak of UPSI. Listed companies should make employees aware of policies and procedures for whistle blowing.

## 3.6. Provision for aiding investigations on insider trading

As mentioned earlier, investigation of insider trading is a challenging task and it is not easily possible to establish the link between the insiders who had access to UPSI and the persons who traded making use of such UPSI. The links may be tenuous as the persons who benefit from inside information may be school/college friends, relatives, ex-colleagues, professional contacts, or social contacts. At times, insider trading may also be done in the name of a front entity who may have no obvious link to the insider. Hence, mechanisms need to be built to enable establishment of such connections in case there is suspicion of insider trading. These mechanisms will not only help in investigating insider trading but may also prove to be a deterrent to insider trading.

These mechanisms are primarily based on building a database of information within the listed company/ intermediary of persons who are connected to the “designated persons” as defined in the PIT Regulations so that, if required, a chain of connections can be traced quickly.

**Recommendations**

The Committee recommends that a new regulation may be added in the SEBI (PIT) Regulations to include the following requirements:

1. Designated persons should disclose to the listed company/ market intermediaries / other entities as applicable, the following information on an annual basis:
   - Names of immediate relatives including spouse of designated person, parents, siblings, or children of such designated person or of the spouse, irrespective of whether they are dependent financially on such designated person or not.
   - Names of persons with whom such designated person(s) share a material financial relationship
   - Names of persons residing at the same address at which designated persons reside for more than one year
   - Phone / mobile /cell numbers which are accessible by them or whose billing address is residence address of the designated person.

2. For this purpose, the term “material financial relationship” shall mean a relationship in which one person is a recipient of any kind of payment such as by way of a loan, or gift, during the immediately preceding twelve months, equivalent to at least 25% or such percentage as notified by SEBI from time to time of such payer’s annual income. However “material financial relationship” shall exclude relationships in which the payment is based on arm’s length transactions. This kind of relationship is being included to cover those cases where the insider may have funded otherwise unconnected persons to trade on his behalf in order to evade detection. The designated person should disclose the following information on a one time basis

- Names of educational institutions where designated persons have graduated from
- Names of their past employers.

The Committee recommends that the aforesaid disclosures made by designated person should be maintained by the respective listed company or entities, while ensuring full confidentiality of such information. SEBI should seek information from the respective listed company or entity in a searchable electronic format on need to know basis for investigating. Further, it is clarified that persons who are named as above by designated persons shall not be deemed to be connected persons for insider trading regulations unless otherwise covered under the relevant regulations.

### 3.7. Confidentiality agreements / Notice while communicating UPSI

Persons with whom UPSI is shared as permissible under the PIT Regulations should be made aware of the duties and responsibilities attached to the receipt of UPSI and the liability that attaches to misuse or unwarranted use of such information. This can be achieved by signing confidentiality agreements or non-disclosure agreements or by serving of the notice.

**Recommendations**

The Committee recommends that a new regulation may be added in the SEBI (PIT) Regulation to include the following requirements:

Listed companies/ market intermediary may sign specific personal confidentiality agreements with those with whom UPSI is shared making clear the responsibility of such persons vis-a-vis the PIT Regulation. These confidentiality agreements should restrict individuals from discussing confidential information with other people who are not authorised. The agreements should also deal with document management, meeting protocols, securities trading restrictions and other confidentiality issues etc.

If it is not practical to sign confidentiality agreements, then a notice may be given to the person receiving UPSI containing necessary safeguards to be adopted by such person.

**The amendments to the PIT Regulations suggested on the above lines are placed at Annexure II and III.**

## CHAPTER 4 | SURVEILLANCE, INVESTIGATION AND ENFORCEMENT

One of the terms of reference of the Committee was to suggest short-term and medium-term measures for improved surveillance of the markets as well as issues relating to high frequency trades, harnessing of technology and analytics in surveillance. The Committee noted that having appropriate laws/ regulations is one aspect of ensuring market integrity, fair market conduct and protection of interest of investors. However, to ensure that the laws and regulations are followed is equally important. For this purpose, mechanisms are necessary for detection of violations through effective surveillance and investigation and punishment thereof by strong enforcement action.

The Committee reviewed the current processes followed by SEBI for surveillance, investigation and enforcement, and the hurdles faced by SEBI for effective enforcement of securities laws from the perspective of whether any improvements could be suggested such as more efficient use of technology, need for additional powers to augment investigation capacity and measures to enhance surveillance and enforcement.

### 4.1. High Frequency Trading ("HFT") / Algorithmic trading ("algo trading")

HFT or algo trading is perceived as a new risk in securities markets because of various reasons, such as the use of opaque algorithms for trading, high speed of trading due to use of powerful technology and the growing percentage of such orders and trades generated by HFT/ algo trading systems as a percentage of total trading volumes.

In order to examine the scope for improvement and risk-containment, the Committee (through one of the sub-committees – Investigation and Enforcement sub-committee) sought presentations by NSE and BSE on the systems used by them for surveillance of HFT/ algo trading.

The following concerns with respect to HFT/algo trading were noted by the Committee -

a) High orders to trade ratio – the number of orders placed as a proportion to trades taking place is very high due to the high speed with which orders can be placed and cancelled;

b) High cancellation of orders – Orders are placed fleetingly, either to gauge order book (to get an idea of the market for the scrip at that point of time) or create an impression of order flow, and then are quickly cancelled;
c) Possible unusual price behaviors – Algo trading could possibly cause unusual price movements due to nature of high speed order flow;
d) Possible choking of the exchange system resulting in Trading Halt – The capacity to throw large numbers of orders at the trading system could potentially choke the trading system;
e) Effect on level playing field for retail investor – retail investors are unable to invest in such technology and hence lose out on price-time priority when placing orders.

**Recommendations**

After deliberation, the Committee recommends that for improving surveillance of HFT / Algo trading, the following measures may be taken:-

a) Allotment of a Unique Identification Number to each approved algorithm, which shall reflect in the orders generated by the said algorithm. This would help in identifying algorithms which generate potentially manipulative trades.
b) Collection of information about the algorithm by the exchanges in a structured format as suggested jointly by BSE and NSE before providing a limited approval of the algorithm. The system of approval for algo trades requires brokers to submit some information about the algorithms to exchanges. As the exchanges provide a limited approval of the algorithm, they should provide a necessary disclaimer about the extent of approval.
c) Self-certification is a mechanism to place responsibility on the brokers about the technology deployed by them for HFT/ Algo trading. Brokers may be advised to ensure self-certification regarding compliance of algorithms with specified norms/ risk checks, in order to encourage them to take responsibility for ethical use of the technology deployed by them; and
d) Implementation of certain “Model Risk Checks for Algo Trading” as suggested by the sub-committee on Technology are suggested at **Annexure ‘V’**.

The Committee noted that many of the aforesaid measures were implemented during the course of proceedings of the Committee report. The Committee endorses these measures.

### 4.2. Measures to curb manipulation

The Committee noted that lack of liquidity in certain stocks made it easier to manipulate the price and volume of stocks with lesser efforts and funds by unscrupulous elements. The Committee also noted that liquidity was concentrated around the top 500 odd listed stocks, while the total listed stocks which were traded numbered around 2000. The Committee also noted that many of these stocks had very low market capitalization.

The Committee noted that SEBI and Stock Exchanges were getting overburdened due to actions emerging out of manipulation in the small cap companies. The Committee noted that the large number of cases coming under investigation in the small cap companies were leading to blockage of administrative time and resources of the regulatory machinery while also posing a threat to market activities.

The Committee noted that with increase in monitoring and surveillance, the number of cases being taken up for investigation by SEBI is expected to be on a rise. In order to ensure that critical cases / emerging trends needing immediate attention are identified and resolved as quickly as possible to reduce market impact and set an example for market participants, the Committee is of the view that it would be prudent to adopt a risk-based approach for the purpose of investigation and surveillance.

**Recommendation**

A two-tiered approach of investigation and enforcement is recommended to be followed wherein sensitive cases/new types of manipulation/cases involving large-cap companies are proposed to be handled by designated SEBI officials to fast-track them, while regular cases are handled by other officials in the normal course.

In order to deter attempts at manipulation in stocks which are illiquid and have low market capitalization, the Committee suggests that SEBI may consider the following:-

a) Increasing cost of trading in stocks of such companies
b) Taking graded surveillance measures for such stocks
c) 100 % dematerialization of shares of these companies

### 4.3. Power to Intercept Conversation

The Committee noted that though call records constitute important evidence which aids investigation, SEBI does not have the right to intercept telephonic conversations. While the Committee acknowledged that currently there are several methods of electronic communication apart from telephone calls which are fairly widely used, and that telephone call interception may only provide information on a subset of potential evidence of wrong doing, it still felt that call interception would be an improvement over the present case where no interception is possible. The Committee suggested that interception of electronic communication should also be covered in the powers being sought. It was also discussed that this would help to track repetitive offenders and it may not help in the case of one off cases of unauthorized information sharing, as a ground would need to be prepared to initiate telephone interception based on a pattern of potential offenses. Thus, the Committee recommends that SEBI should seek power to intercept telephone calls and electronic communication, to collect strong evidence against repetitive offenders in cases including those of insider trading, front running or market manipulation.

In respect of using this power directly or through other enforcement agencies, the Committee deliberated the following pros and cons:

| **Power to Intercept Conversation** | **Pros and Cons** |
|---|---|
| Through other enforcement agency | The other agency may not give preference and priority to SEBI requests for call recording which may delay the evidence collection. |
| Direct Power | The direct power will come with huge responsibility to ensure that the same is not misused. |

**Recommendation**

The Committee recommends that SEBI may seek direct power to intercept calls but ensure proper checks and balances for use of the power by necessary amendment in the relevant laws. The power sought to intercept conversation details may be equivalent to power given to other regulatory agencies, such as the Central Board of Direct Taxes, to deal with economic offences.

### 4.4. Inter-regulatory Cooperation

During the course of discharge of their functions, different statutory bodies and enforcement agencies of the Government which deal with economic offences and financial crimes, such as the Reserve Bank of India, the Enforcement Directorate (under the Prevention of Money Laundering Act, 2002) the Central Board of Direct Taxes (under the Central Boards of Revenue Act, 1963 ) or the Economic Offences Wing of the State Police, may acquire evidence on issues which SEBI may find useful in supporting its own investigation. Joint investigations and co-operation with such authorities could ensure that investigation is effective, discreet where required, and supported by strong evidence. Hence the Committee felt that it would be prudent to have a mechanism for information sharing with such agencies.

**Recommendation**

The Committee recommends that SEBI sign a Memorandum of Understanding amongst the various regulatory bodies and enforcement agencies like Income Tax, EOW, RBI, ED, MCA etc. for information-sharing and joint investigation in certain cases, to enable speedy and effective investigation of economic offences.

### 4.5. Whistleblower Mechanism

The Committee deliberated that Whistleblower Mechanism is an important tool to obtain information on market abuse such as market manipulation and insider trading. In the absence of a whistle blowing or similar mechanism, there is little incentive to voluntarily disclose such unlawful dealings as people will be charged for violations on par with other violators who conceal information. It was discussed that it might be useful for SEBI to have a mechanism to deal with and encourage Whistleblowing.

To encourage whistleblowing by a person who has knowingly or unknowingly become part of such market abuse, SEBI should have power to grant immunity or impose less penalty on a person who brings market manipulation, insider trading or other violations to the notice of SEBI.

Section 24 B of SEBI Act, 1992 deals with "Power to grant immunity". As per the current provision, the Central Government may, on recommendation by the Board, grant immunity to any person from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation.

The provision states as under -

*24 B (1) The Central Government may, on recommendation by the Board, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of the alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation:*

*Provided that no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity:*

*Provided further that recommendation of the Board under this sub-section shall not be binding upon the Central Government.*

*(2) An immunity granted to a person under sub-section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the*

*imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted."*

**Recommendation**

The Committee noted that the Central Government has not yet used the power to grant immunity in terms of section 24 of the SEBI Act. It also noted that SEBI has also not yet made any recommendation to the Central Government for granting immunity to any person.

The Committee recommends that the Central Government may consider delegating power to grant immunity to SEBI by making necessary amendments to section 24 B (1) of SEBI Act, 1992.

It is suggested that the section may be amended to give power to SEBI to grant complete immunity or impose lesser penalty along the lines of a similar provision in Section 46 of the Competition Act, 2002. Further as a matter of policy, SEBI may consider providing adequate protection to whistleblowers during the course of enforcement actions.

**The amendments to the SEBI Act, 1992 suggested on the above lines are placed at Annexure IV.**

## 4.6. Discouraging Layering of Funds

SEBI has often encountered cases where individuals without the means or wherewithal to commit economic offences have been used as a front for commission of violations of law by the actual offenders. The use of front entities or "mule accounts" enables layering of funds / securities between the source and the front entity who invests/trades in the securities market. The Committee deliberated on ways to discourage "mule accounts" for the purpose of manipulation whereby the real perpetrators of scheme of manipulation remain untraced. In this context, it was suggested that a mechanism may be put in place to prevent use of such mule account, by requiring persons who trade to demonstrate their financial capacity to trade. Where manipulation is done using such front entities/ mule accounts, the persons who are responsible for creating such accounts and directly or

indirectly providing them funds, also need to be held accountable for such manipulation.

**Recommendations**

The Committee recommends that SEBI may consider the following -

a) Rules may be framed to decide on an "affordability index" (like the CIBIL score) based on income / net worth of investor which will establish affordability of transactions.
b) Broker may be made responsible to calculate affordability index based on supporting documents of income and /or net worth given by client. Mechanics of construction of such index may be notified by SEBI after due consultation with market participants.
c) Based on this, a certain volume of trading would be considered normal. If exceeding the specified volume upto the next prescribed level, broker may be required to enhance diligence. If the trading volume is even higher than that prescribed level, the account would be suspected to be a mule account.
d) This would be rebuttable by submitting appropriate documents.
e) Appropriate amendments are recommended in the PFUTP regulations in the Chapter 1 of this report.

## 4.7. Structured library of orders passed by SEBI, SAT and Courts.

Competent knowledge management is helpful to an organization like SEBI in enabling quick verification of the legality of proposed actions, propriety of procedures of investigation and adequacy of evidence collected, amongst other things. The Committee felt that a structured library of orders passed by SEBI, the Securities Appellate Tribunal and courts, may be made available for use within SEBI. This facility, alongwith data mining and analytical tools, will be useful in evidence collection at investigation stage, and may be used for reference while passing orders as well as for policy review. The library would be an exhaustive database, easily searchable and cross-referenced to related litigation.

NSE informed the Committee that it has built an e-book on orders passed by the Securities Appellate Tribunal. It was noted that SEBI orders are publicly available documents and there are several products available in the market which provide data

mining facility on SEBI orders.

**Recommendation**

SEBI may consider hiring a vendor or may create its own customized package for creating the structured library

## ANNEXURE I

## Amendments to SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations 2003

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| **2** | **Definitions** | |
| (1) | In these regulations, unless the context otherwise requires: | |
| (b) | "dealing in securities" includes an act of buying, selling or subscribing pursuant to any issue of any security or agreeing to buy, sell or subscribe to any issue of any security or otherwise transacting in any way in any security by any persons as principal, agent, or intermediary referred to in section 12 of the Act | "dealing in securities" includes an act of buying, selling or subscribing pursuant to any issue of any security or agreeing to buy, sell or subscribe to any issue of any security or otherwise transacting in any way in any security by any persons **including** as principal, agent, or intermediary referred to in section 12 of the Act **and shall also include such acts (or omissions) which may be knowingly designed to influence the decision of investors in securities; and any act of providing assistance to carry out the aforementioned acts.** |
| **4.** | **Prohibition of manipulative, fraudulent and unfair trade practices** | |
| (1) | Without prejudice to the provisions of regulation 3, no person shall indulge in a fraudulent or an unfair trade practice in securities. | Without prejudice to the provisions of regulation 3, no person shall indulge in **a manipulative**, a fraudulent or an unfair trade practice in securities **markets**. |

| | | |
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| (2) | Dealing in securities shall be deemed to be a fraudulent or an unfair trade practice if it involves fraud and may include all or any of the following, namely:— | Dealing in securities shall be deemed to be a **manipulative,** fraudulent or an unfair trade practice if it involves ~~**fraud.**~~ ~~**and may include all or**~~ **any of the following**~~**, namely**~~**:** |
| (a) | indulging in an act which creates false or misleading appearance of trading in the securities market; | **Knowingly** indulging in an act which creates false or misleading appearance of trading in the securities market |
| (b) | dealing in a security not intended to effect transfer of beneficial ownership but intended to operate only as a device to inflate, depress or cause fluctuations in the price of such security for wrongful gain or avoidance of loss; | - |
| (c) | advancing or agreeing to advance any money to any person thereby inducing any other person to offer to buy any security in any issue only with the intention of securing the minimum subscription to such issue; | ~~advancing or agreeing to advance any money to any person thereby~~ **fraudulently** inducing any person to offer to buy any security in any issue **by advancing or agreeing to advance any money to any person or through any other mechanism** only with the intention of securing the minimum subscription to such issue; |
| (d) | paying, offering or agreeing to pay or offer, directly or indirectly, to any person any money or money's worth for inducing such person for dealing in any security with the | ~~paying, offering or agreeing to pay or offer, directly or indirectly, to any person any money or money's worth for~~ inducing ~~such~~ **any** person for dealing in any security with the ~~**object**~~ **objective** of **artificially** inflating, depressing, maintaining or |

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| | object of inflating, depressing, maintaining or causing fluctuation in the price of such security; | causing fluctuation in the price of such security **through any mechanism** including **by paying, offering or agreeing to pay or offer, directly or indirectly, to any person any money or money's worth ;** |
| (e) | any act or omission amounting to manipulation of the price of a security; | any act or omission amounting to manipulation of the price of a security;<br>**Explanation – dealing in securities to influence or manipulate the reference price or bench mark price, with the object of misleading investors acting on the basis of such prices shall also be considered an act amounting to manipulation of the price of a security.** |
| (f) | publishing or causing to publish or reporting or causing to report by a person dealing in securities any information which is not true or which he does not believe to be true prior to or in the course of dealing in securities; | **Knowingly** publishing or causing to publish or reporting or causing to report by a person dealing in securities any information **relating to securities (including financial results, financial statements, mergers and acquisitions, regulatory approvals, etc. )** which is not true or which he does not believe to be true prior to or in the course of dealing in securities; |
| (g) | entering into a transaction in securities without intention of performing it or without intention of change of ownership of such security; | - |
| (h) | selling, dealing or pledging of stolen or counterfeit security | selling, dealing or pledging of stolen, ~~or~~counterfeit **or fraudulently issued** |

| | | |
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| | whether in physical or dematerialized form; | **securities** whether in physical or dematerialized form**; provided that if (a) the person selling, dealing in or pledging stolen, counterfeit or fraudulently issued securities was a holder in due course; or (b) the stolen, counterfeit or fraudulently issued securities were previously traded on the market through a bonafide transaction, such selling, dealing or pledging of stolen, counterfeit or fraudulently issued securities shall not be considered as a manipulative, fraudulent, or unfair trade practice;** |
| (i) | an intermediary promising a certain price in respect of buying or selling of a security to a client and waiting till a discrepancy arises in the price of such security and retaining the difference in prices as profit for himself; | **Omitted** |
| (j) | an intermediary providing his clients with such information relating to a security as cannot be verified by the clients before their dealing in such security; | **Omitted** |
| (k) | an advertisement that is misleading or that contains information in a distorted manner and which may | ~~**an advertisement**~~ **disseminating information or advice (through any media, whether physical or digital, including through the use of the** |

| | | |
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| | influence the decision of the investors; | **internet) which the disseminator knows to be false or** misleading ~~**or that contains information in a distorted manner**~~ and which is designed or likely to influence the decision of investors dealing in securities; |
| (l) | an intermediary reporting trading transactions to his clients entered into on their behalf in an inflated manner in order to increase his commission and brokerage; | **Omitted** |
| (m) | an intermediary not disclosing to his client transactions entered into on his behalf including taking an option position; | ~~an intermediary~~ **a market participant** entering into transactions on behalf of client without the knowledge of or instructions from client ~~including taking an option position~~ or misutilizing or diverting the funds or securities of the client held in fiduciary capacity |
| (n) | circular transactions in respect of a security entered into between intermediaries in order to increase commission to provide a false appearance of trading in such security or to inflate, depress or cause fluctuations in the price of such security; | circular transactions in respect of a security entered into between **persons (including** intermediaries) ~~**in order to increase commission**~~ to **artificially** provide a false appearance of trading in such security or to inflate, depress or cause fluctuations in the price or volume of such security; |
| (o) | encouraging the clients by an intermediary to deal in securities solely with the object of | **fraudulent inducement of** ~~**encouraging the**~~ any person by **a market participant** ~~**an intermediary**~~ to deal in securities ~~solely~~ |

| | | |
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| | enhancing his brokerage or commission; | with the object of enhancing his brokerage or commission **or income**; |
| (p) | an intermediary predating or otherwise falsifying records such as contract notes. | a market participant predating or otherwise falsifying records ~~such as~~ **including** contract notes, **client instructions, balance of securities statement, client account/ statements etc.** |
| (q) | an intermediary buying or selling securities in advance of a substantial client order or whereby a futures or option position is taken about an impending transaction in the same or related futures or options contract. | ~~an intermediary buying or selling securities in advance of a substantial client order or whereby a futures or option position is taken about an impending transaction in the same or related futures or options contract.~~<br>***Any order in securities placed by a person, while directly or indirectly in possession of information that is not publically available, regarding a substantial impending transaction in that security, its underlying security or its derivative*** |
| (r) | planting false or misleading news which may induce sale or purchase of securities. | **Knowingly** planting false or misleading news **or information** which may induce sale or purchase of securities and such news or information should affect the price of the security |
| (s) | mis-selling of units of a mutual fund scheme;<br>Explanation- For the purpose of this clause, "mis-selling" means sale of units of a mutual fund | mis-selling of ~~units~~ **securities or services relating to securities market ~~a mutual fund scheme~~**;<br>Explanation- For the purpose of this clause, "mis-selling" means sale of **securities or services relating to ~~units~~ securities** |

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| | scheme by any person, directly or indirectly, by—<br>(i) making a false or misleading statement, or<br>(ii) concealing or omitting material facts of the scheme, or<br>(iii) concealing the associated risk factors of the scheme, or<br>(iv) not taking reasonable care to ensure suitability of the scheme to the buyer. | **market** ~~**of a mutual fund scheme**~~ by any person, directly or indirectly, by—<br>(i) **knowingly** making a false or misleading statement, or<br>(ii) **knowingly** concealing or omitting material facts ~~**of the scheme**~~, or<br>(iii) **knowingly** concealing the associated risk ~~**factors of the scheme**~~, or<br>(iv) not taking reasonable care to ensure suitability of ~~**scheme**~~ **the security or service** to the buyer. |
| (t) | illegal mobilization of funds by sponsoring or causing to be sponsored or carrying on or causing to be carried on any collective investment scheme by any person. | No change |
| | **New Regulation** | **(u) dealing or causing to deal in securities by deploying such quantum of funds which are in excess of the verifiable financial sources of the person dealing in securities with the intention of causing manipulation in the price or volume of a security;**<br>**Explanation – The Board may issue such guidelines as may be required to ascertain the verifiable financial sources of a person dealing in securities.** |
| | Explanation– For the purposes of this sub-regulation, for the | No change |

| | | |
|---|---|---|
| | removal of doubts, it is clarified that the acts or omissions listed in this sub-regulation are not exhaustive and that an act or omission is prohibited if it falls within the purview of regulation 3, notwithstanding that it is not included in this sub-regulation or is described as being committed only by a certain category of persons in this sub-regulation. | |
| | | **Explanation: Market Participant shall include any person or entity registered under Section 12 of SEBI Act and its employees and agents.** |

## ANNEXURE II

## Amendments to SEBI (Prohibition of Insider Trading) Regulations, 2015.

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| **2** | **Definitions** | - |
| (1) | In these regulations, unless the context otherwise requires, the following words, expressions and derivations therefrom shall have the meanings assigned to them as under: | - |
| (c) | "compliance officer" means any senior officer, designated so and reporting to the board of directors or head of the organization in case board is not there, who is financially literate and is capable of appreciating requirements for legal and regulatory compliance under these regulations and who shall be responsible for compliance of policies, procedures, maintenance of records, monitoring adherence to the rules for the preservation of unpublished price sensitive information, monitoring of trades and the implementation of the codes specified in these regulations under the overall supervision of the board of directors of the listed company or the head of an organization, as the case may be; | "compliance officer" means any senior officer, designated so and reporting to the board of directors or head of the organization in case board is not there, who is financially literate and is capable of appreciating requirements for legal and regulatory compliance under these regulations and who shall be responsible for compliance of policies, procedures, maintenance of records, monitoring adherence to the rules for the preservation of confidentiality of unpublished price sensitive information, monitoring of trades and the implementation of the codes specified in these regulations under the overall supervision of the board of directors of the listed company or the head of an organization, as the case may be; |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | | **Explanation 1 – For the purpose of this Regulation, "financially literate" shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows** |
| | - | **(ha) "proposed to be listed" shall mean (i) such unlisted company which has filed offer documents or other documents, as the case may be, with SEBI, stock exchange(s) or registrar of companies in connection with listing and the securities of such company are not yet listed; and (ii) such unlisted company which has filed a draft scheme of arrangement under the Companies Act 2013, with the stock exchanges for obtaining observations or no-objection confirmations under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and the securities of such company are not yet listed.** |
| (n) | "unpublished price sensitive information" means any information, | "unpublished price sensitive information" means any information, |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | 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:<br>(i) financial results;<br>(ii) dividends;<br>(iii) change in capital structure;<br>(iv) mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions;<br>(v) changes in key managerial personnel; and<br>(vi) material events in accordance with the listing agreement. | 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:<br>(i) financial results;<br>(ii) dividends;<br>(iii) change in capital structure;<br>(iv) mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions; and<br>(v) changes in key managerial personnel;<br>(vi) ~~**material events in accordance with the listing agreement.**~~ |
| **3** | **Communication or procurement of unpublished price sensitive information.** | - |
| (2) | No person shall procure from or cause the communication by any insider of unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, except in furtherance of | No person shall procure from or cause the communication by any insider of unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, except in |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | legitimate purposes, performance of duties or discharge of legal obligations. | furtherance of legitimate purposes, performance of duties or discharge of legal obligations. **The board of directors of a listed company may make a policy for determination of "legitimate purposes" as a part of "Codes of Fair Disclosure and Conduct" formulated under the Regulation 8.**<br>**Explanation – For the purpose of illustration, the term "legitimate purpose" shall include sharing of UPSI in the ordinary course of business by an insider with partners, collaborators, lenders, customers, suppliers, merchant bankers, legal advisors, auditors, insolvency professionals or other advisors or consultants, provided that such sharing has not been carried out to evade or circumvent the prohibitions of these regulations;**<br>**And provided further that any person in receipt of unpublished price sensitive information pursuant to a "legitimate purpose" shall be considered an "insider" for purposes of these** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | | **regulations and due notice shall be given to such persons to maintain confidentiality of such UPSI in compliance with these regulations.** |
| (3) | Notwithstanding anything contained in this regulation, an unpublished price sensitive information may be communicated, provided, allowed access to or procured, in connection with a transaction that would: | - |
| (i) | entail an obligation to make an open offer under the takeover regulations where the board of directors of the company is of informed opinion that the proposed transaction is in the best interests of the company;<br>NOTE: It is intended to acknowledge the necessity of communicating, providing, allowing access to or procuring UPSI for substantial transactions such as takeovers, mergers and acquisitions involving trading in securities and change of control to assess a potential investment. In an open offer under the takeover regulations, not only would the same price be made available to all shareholders of the company but also all information necessary to enable an | entail an obligation to make an open offer under the takeover regulations where the board of directors of the **listed** company is of informed opinion that ~~**the proposed transaction**~~ **sharing of such information** is in the best interests of the company;<br>NOTE: It is intended to acknowledge the necessity of communicating, providing, allowing access to or procuring UPSI for substantial transactions such as takeovers, mergers and acquisitions involving trading in securities and change of control to assess a potential investment. In an open offer under the takeover regulations, not only would the |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | informed divestment or retention decision by the public shareholders is required to be made available to all shareholders in the letter of offer under those regulations. | same price be made available to all shareholders of the company but also all information necessary to enable an informed divestment or retention decision by the public shareholders is required to be made available to all shareholders in the letter of offer under those regulations. |
| (ii) | not attract the obligation to make an open offer under the takeover regulations but where the board of directors of the company is of informed opinion that the proposed transaction is in the best interests of the company and 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.<br>***NOTE***: *It is intended to permit communicating, providing, allowing access to or procuring UPSI also in transactions that do not entail an open offer obligation under the takeover regulations if it is in the best interests of the company. The board of directors, however, would cause public* | not attract the obligation to make an open offer under the takeover regulations but where the board of directors of the **listed** company is of informed opinion that the ~~**proposed transaction**~~ **sharing of such information** is in the best interests of the company, and 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**.<br>***NOTE****: It is intended to permit communicating, providing, allowing access to or procuring UPSI also in transactions that do not entail an* |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | *disclosures of such unpublished price sensitive information well before the proposed transaction to rule out any information asymmetry in the market.* | *open offer obligation under the takeover regulations,* ***when authorised by the board of directors if sharing of such infromation~~—it—~~is in the best interests of the company****. The board of directors, however, would cause public disclosures of such unpublished price sensitive information well before the proposed transaction to rule out any information asymmetry in the market.* |
| (4) | For purposes of sub-regulation (3), the board of directors shall require the parties to execute agreements to contract confidentiality and non-disclosure obligations on the part of such parties and such parties shall keep information so received confidential, except for the purpose of sub-regulation (3), and shall not otherwise trade in securities of the company when in possession of unpublished price sensitive information. | For purposes of sub-regulation (3), the board of directors shall require the parties to execute agreements to contract confidentiality and non-disclosure obligations on the part of such parties and such parties shall keep information so received confidential, except for the purpose of sub-regulation (3), and shall not otherwise trade in securities of the company when in possession of unpublished price sensitive information. |
| (5) | - | **The board of directors shall ensure that a structured digital database is maintained containing the names of such** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | | **persons with whom information is shared under this regulation along with the Permanent Account Number (PAN) or similar identification where PAN is not available. Such databases shall be maintained with adequate internal controls and checks such as time stamping and audit trails to ensure non-tampering of the database.**<br>**<u>NOTE:</u> If UPSI is shared by a listed company with an entity, the name and PAN of such entity shall be recorded by the listed company and that entity in turn shall record the names and PAN of its employees who have access to such UPSI as per Code of Conduct applicable to such entity under Regulation 9.** |
| **4** | **Trading when in possession of unpublished price sensitive information.** | - |
| (1) | No insider shall trade in securities that are listed or proposed to be listed on a stock exchange when in possession of unpublished price sensitive information: | - |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | - | **Provided that when a person who has traded in securities has been in possession of unpublished price sensitive information, his trades would be presumed to have been motivated by the knowledge and awareness of such information in his possession;** |
| | Provided that the insider may prove his innocence by demonstrating the circumstances including the following: | Provided **further** that the insider may prove his innocence by demonstrating the circumstances including the following: |
| (i) | the transaction is an off-market *inter-se* transfer between promoters who were in possession of the same unpublished price sensitive information without being in breach of regulation 3 and both parties had made a conscious and informed trade decision | **(i)** the transaction is an off-market *inter-se* transfer between ~~**promoters**~~ **insiders and** were in possession of the same unpublished price sensitive information without being in breach of regulation 3 and both parties had made a conscious and informed trade decision**;**<br>**Provided that such unpublished price sensitive information was not obtained under Regulation 3 (3) of the PIT Regulations.** |
| | | **(ii) the transaction was carried out through the block deal window mechanism between persons who were in possession** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | | **of the unpublished price sensitive information without being in breach of regulation 3 and both parties had made a conscious and informed trade decision;**<br>**Provided that such unpublished price sensitive information was not obtained by either person under Regulation 3 (3) of the PIT Regulations.** |
| | | **(iii) the transaction in question was carried out pursuant to a bona fide statutory or regulatory obligation to carry out such transaction.** |
| | | **(iv) the transaction in question was undertaken pursuant to the exercise of stock options in respect of which the exercise price was pre-determined in compliance with applicable regulations.** |
| (ii) | in the case of non-individual insiders: | ~~**(ii)**~~ **(v)** in the case of non-individual insiders: |
| (a) | the individuals who were in possession of such unpublished price sensitive information were different from the individuals taking trading decisions and such decision-making individuals | - |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | were not in possession of such unpublished price sensitive information when they took the decision to trade; and | |
| (b) | appropriate and adequate arrangements were in place to ensure that these regulations are not violated and no unpublished price sensitive information was communicated by the individuals possessing the information to the individuals taking trading decisions and there is no evidence of such arrangements having been breached; | - |
| (iii) | the trades were pursuant to a trading plan set up in accordance with regulation 5 | - |
| **5** | **Trading Plans** | |
| **(3)** | The compliance officer shall review the trading plan to assess whether the plan would have any potential for violation of these regulations and shall be entitled to seek such express undertakings as may be necessary to enable such assessment and to approve and monitor the implementation of the plan. | The compliance officer shall review the trading plan to assess whether the plan would have any potential for violation of these regulations and shall be entitled to seek such express undertakings as may be necessary to enable such assessment and to approve and monitor the implementation of the plan.<br>**Provided that pre-clearance of trades shall not be required for** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | | **any trades in accordance with the trading plan once trading plan has been approved by the compliance officer.**<br>**Provided further that trading window norms and restrictions on contra trade shall not be applicable for trades carried out in accordance with the trading plan approved by the compliance officer.** |
| **7** | **Disclosures by certain persons.** | - |
| (2) | *Continual Disclosures.*<br>Every promoter, employee and director of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified; | *Continual Disclosures.*<br>Every promoter, ~~**employee**~~ **designated person** and director of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified; |
| **9** | **Code of Conduct.** | - |
| (1) | The board of directors of every listed company and market intermediary | The board of directors of every listed company and **the board of** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | shall formulate a code of conduct to regulate, monitor and report trading by its employees and other connected persons towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule B to these regulations, without diluting the provisions of these regulations in any manner.<br>**NOTE**: It is intended that every company whose securities are listed on stock exchanges and every market intermediary registered with SEBI is mandatorily required to formulate a code of conduct governing trading by its employees. The standards set out in the schedule are required to be addressed by such code of conduct. | **directors or head(s) of the organisation of every market intermediary shall ensure that the chief executive officer / managing director** formulate a code of conduct to regulate, monitor and report trading by its ~~**employees and other connected persons**~~ **designated persons and immediate relatives of designated persons** towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule B **(in case of a listed company) and Schedule C (in case of a market intermediary)** to these regulations, without diluting the provisions of these regulations in any manner.<br>**For the avoidance of doubt it is clarified that market intermediaries, which are listed, would be required to formulate a code of conduct to regulate, monitor and report trading by its designated persons, by: (a) adopting the minimum standards set out in Schedule B with respect to trading in its own securities, and (b) adopting the** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
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| | | **minimum standards set out in Schedule C with respect to trading in other securities.**<br>**The board of directors or such other analogous authority shall in consultation with the compliance officer specify the designated persons to be covered by the code of conduct on the basis of their role and function in the organisation and the access that such role and function would provide to unpublished price sensitive information in addition to seniority and professional designation.**<br>***NOTE**: It is intended that every company whose securities are listed on stock exchanges and every market intermediary registered with SEBI is mandatorily required to formulate a code of conduct governing trading by **~~its employees~~** **designated persons and their immediate relatives**. The standards set out in the **~~schedule~~** **schedules** are required to be addressed by such code of conduct.* |
| (2) | Every other person who is required to handle unpublished price sensitive | **The board of directors or head(s) of the organisation, of e**very other |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | information in the course of business operations shall formulate a code of conduct to regulate, monitor and report trading by employees and other connected persons towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule B to these regulations, without diluting the provisions of these regulations in any manner.<br>**NOTE**: This provision is intended to mandate persons other than listed companies and market intermediaries that are required to handle unpublished price sensitive information to formulate a code of conduct governing trading in securities by their employees. These entities include professional firms such as auditors, accountancy firms, law firms, analysts, consultants etc., assisting or advising listed companies, market intermediaries and other capital market participants. Even entities that normally operate outside the capital market may handle unpublished price sensitive information. This provision | ~~**person who**~~ **entity or any other person that**[28] is required to handle unpublished price sensitive information in the course of business operations shall formulate a code of conduct to regulate, monitor and report trading by ~~**employees and other connected persons**~~ **their designated persons and immediate relative of designated persons** towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule ~~**B**~~ **C** to these regulations, without diluting the provisions of these regulations in any manner.<br>***Explanation: Professional firms such as auditors, accountancy firms, law firms, analysts, insolvency professional entities, consultants, banks etc., assisting or advising listed companies shall be collectively referred to as fiduciaries for the purpose of these Regulations.***<br>***NOTE****: This provision is intended to mandate* ~~***persons***~~ ***entities*** *other* |

[28] ***Rationale***: This change has been made to align it with the reference(s) to "entities" in the legislative note and "organization" in Clause 3.

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| | would mandate all of them to formulate a code of conduct. | *than listed companies and market intermediaries that are required to handle unpublished price sensitive information to formulate a code of conduct governing trading in securities by their* ~~***employees***~~ ***designated persons****. These entities include professional firms such as auditors, accountancy firms, law firms, analysts,* ***insolvency professional entities,*** *consultants,* ***banks*** *etc., assisting or advising listed companies*~~***, market intermediaries and other capital market participants***~~*. Even entities that normally operate outside the capital market may handle unpublished price sensitive information. This provision would mandate all of them to formulate a code of conduct.*<br>**The board of directors or such other analogous authority shall in consultation with the compliance officer specify the designated persons to be covered by the code of conduct on the basis of their role and function in the organisation and the access that such role and function would** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
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| | | **provide to unpublished price sensitive information in addition to seniority and professional designation.** |
| (3) | Every listed company, market intermediary and other persons formulating a code of conduct shall identify and designate a compliance officer to administer the code of conduct and other requirements under these regulations.<br>**NOTE**: This provision is intended to designate a senior officer as the compliance officer with the responsibility to administer the code of conduct and monitor compliance with these regulations. | **-** |
| | | **Explanation – The term "designated person(s)" for purposes of these regulations shall mean**<br>**(i) employees of such listed company / market intermediaries/ fiduciaries and its material subsidiaries and associates company (s), designated on the basis of their functional role or access to UPSI in the organization by its Board.** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
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| | | (ii) All promoters for listed companies and promoters who are individuals or investment companies for market intermediaries/ fiduciaries<br>(iii) CEO and upto two levels below CEO of such listed company / market intermediary/ fiduciaries and its material subsidiaries and associate company (s) irrespective of their functional role in the company or ability to have access to UPSI.<br>(iv) any support staff of listed company/ market intermediary/ fiduciaries such as IT staff or secretarial staff who have access to UPSI. |
| | NEW Regulation | Institutional Mechanism for Prevention of Insider trading |
| (1) | | The Chief Executive Officer / Managing Director or such other analogous person of a listed company /market intermediary / fiduciary shall put in place adequate and effective system of |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
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| | | **internal controls to ensure compliance with the requirements given in these to prevent insider trading.** |
| **(2)** | | **The internal controls shall include the following:**<br>a) **All employees who have access to UPSI are identified as designated employee.**<br>b) **All the unpublished price sensitive information shall be identified and its confidentiality maintained as per the requirements of the these Regulations**<br>c) **Adequate restrictions shall be placed on communication or procurement of unpublished price sensitive information as required by these Regulations**<br>d) **Lists of all employees and other person with whom UPSI is shared shall be maintained and confidentiality agreements signed or Notice served to all such employees and persons**<br>e) **All other relevant requirements specified under** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
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| | | **the PIT Regulations shall be complied with.**<br>f) **Periodic process review to evaluate effectiveness of such internal controls**. |
| **(2)** | | **The board of directors of every listed company and the board of directors or head(s) of the organisation of market intermediary/ fiduciaries shall ensure that the Chief Executive Officer / Managing Director or such other analogous person ensures compliance with regulations 9 and sub-regulation (1) and (2) of this regulation** |
| **(3)** | | **The Audit Committee of a listed company or other analogous body for market intermediary or fiduciaries shall review compliance with provisions of these Regulations and shall verify that the systems for internal control are adequate and are operating effectively, at least once in a financial year.** |
| **(4)** | | **Every listed company shall formulate written policies and procedures for inquiry in case of leak of unpublished price** |

| REG. | EXTANT PROVISION | PROPOSED AMENDMENTS |
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| | | **sensitive information or suspected leak of unpublished price sensitive information, which shall be approved by Board of Directors of the company and accordingly initiate appropriate inquiries on becoming aware of leak of UPSI or suspected leak of UPSI and inform SEBI promptly of such leaks, inquiries and results of such inquiries..** |
| **(5)** | | **The listed company shall have whistle-blower policies and make employees aware of such policies to enable employees to report instances of leak of UPSI.** |
| **(6)** | | **If an inquiry has been initiated by a listed company in case of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information, the relevant Market Intermediaries and fiduciaries shall co-operate with the listed company in connection with such inquiry conducted by listed company.** |

## ANNEXURE III

## Amendments to SEBI (Prohibition of Insider Trading) Regulations, 2015 – Minimum Standards for Code of Conduct

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
|---|---|---|---|
| | Heading(s) | SCHEDULE B<br>*[See sub-regulation (1) **~~and~~ ~~sub-regulation (2)~~** of regulation 9]*<br>*Minimum Standards for Code of Conduct **for Listed Companies** to Regulate, Monitor and Report Trading by **~~Insiders~~ Designated Persons*** | SCHEDULE **~~B~~C**<br>*[See sub-regulation (1) and sub-regulation (2) of regulation 9]*<br>*Minimum Standards for Code of Conduct **for Market Intermediaries and fiduciaries** to Regulate, Monitor and Report Trading by **~~Insiders~~ Designated Persons*** |
| 1. | Reporting by compliance officer**(s)** | The compliance officer shall report to the board of directors and in particular, shall provide reports to the Chairman of the Audit Committee, if any, or to the Chairman of the board of directors at such frequency as may be stipulated by the board of directors, but not less than once in a year. | The compliance officer shall report to the board of directors **or heads(s) of the organisation (or committee constituted in this regard)** and in particular, shall provide reports to the Chairman of the Audit Committee or other analogous body, if any, or to the Chairman of the board of directors **or heads(s) of the organisation** at such |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
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| | | | frequency as may be stipulated by the board of directors **or heads(s) of the organization but not less than once in a year**. |
| 2. | Chinese walls and communication on need-to-know basis | All information shall be handled within the organisation on a need-to-know basis and no unpublished price sensitive information shall be communicated to any person except in furtherance of ~~**the insider's**~~ legitimate purposes, performance of duties or discharge of ~~**his**~~ legal obligations. The code of conduct shall contain norms for appropriate Chinese Walls procedures, and processes for permitting any designated person to "cross the wall". | All information shall be handled within the organisation on a need-to-know basis and no unpublished price sensitive information shall be communicated to any person except in furtherance of ~~**the insider's**~~ legitimate purposes, performance of duties or discharge of ~~**his**~~ legal obligations. The code of conduct shall contain norms for appropriate Chinese Walls procedures, and processes for permitting any designated person to "cross the wall". |
| 3. | Applicability of the PIT Compliance Code to | ~~**Employees and connected persons designated on the basis of their functional role ("d**~~Designated persons~~**")**~~ and immediate relatives of | ~~**Employees and connected persons designated on the basis of their functional role ("dD**~~esignated persons~~**")**~~ and immediate relatives of |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
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| | "designated person" only | designated persons in the organisation shall be governed by an internal code of conduct governing dealing in securities. ~~**The board of directors shall in consultation with the compliance officer(s) specify the designated persons to be covered by such code on the basis of their role and function in the organisation. Due regard shall be had to the access that such role and function would provide to unpublished price sensitive information in addition to seniority and professional designation.**~~ | designated persons in the organisation shall be governed by an internal code of conduct governing dealing in securities. ~~**The board of directors shall in consultation with the compliance officer(s) specify the designated persons to be covered by such code on the basis of their role and function in the organisation. Due regard shall be had to the access that such role and function would provide to unpublished price sensitive information in addition to seniority and professional designation.**~~ |
| 4. | Trading window | ▪ Designated persons may execute trades subject to compliance with these regulations. Towards this end, a notional trading window shall be used as an instrument of monitoring trading by the designated persons. The trading window | ▪ Designated persons may execute trades subject to compliance with these regulations. ~~**Towards this end, a notional trading window shall be used as an instrument of monitoring trading by the designated persons. The trading**~~ |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
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| | | shall be closed when the compliance officer determines that a designated person or class of designated persons can reasonably be expected to have possession of unpublished price sensitive information. Such closure shall be imposed in relation to such securities to which such unpublished price sensitive information relates. Designated persons shall not trade in securities when the trading window is closed.<br>▪ Trading restriction period can be made applicable from end of every quarter till 48 hours after the declaration of financial results.<br>▪ Gap between clearance of accounts by Audit Committee and Board meeting should be as narrow as possible preferably on the same day to | ~~window shall be closed when the compliance officer determines that a designated person or class of designated persons can reasonably be expected to have possession of unpublished price sensitive information. Such closure shall be imposed in relation to such securities to which such unpublished price sensitive information relates. Designated persons and their immediate relatives shall not trade in securities when the trading window is closed.~~<br>▪ ~~Trading restriction period can be made applicable from end of every quarter till 48 hours after the declaration of financial results.~~<br>▪ ~~Gap between Audit Committee and Board~~ |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
|---|---|---|---|
| | | avoid leakage of material information<br>▪ The timing for re-opening of the trading window shall be determined by the compliance officer taking into account various factors including the unpublished price sensitive information in question becoming generally available and being capable of assimilation by the market, which in any event shall not be earlier than forty-eight hours after the information becomes generally available. ~~The trading window shall also be applicable to any person having contractual or fiduciary relation with the company, such as auditors, accountancy firms, law firms, analysts, consultants etc., assisting or advising the company.~~<br>▪ When the trading window is open, trading by designated | ~~meeting should be as narrow as possible preferably on the same day to avoid leakage of material information~~<br>~~▪ The timing for re-opening of the trading window shall be determined by the compliance officer taking into account various factors including the unpublished price sensitive information in question becoming generally available and being capable of assimilation by the market, which in any event shall not be earlier than forty-eight hours after the information becomes generally available. The trading window shall also be applicable to any person having contractual or fiduciary relation with the company, such as auditors, accountancy firms, law~~ |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
|---|---|---|---|
| | | persons shall be subject to pre- clearance by the compliance officer, if the value of the proposed trades is above such thresholds as the board of directors may stipulate. | ~~**firms, analysts, consultants etc., assisting or advising the company.**~~<br>▪ ~~**When the trading window is open,**~~ **T**rading by designated persons shall be subject to pre- clearance by the compliance officer**(s)**, if the value of the proposed trades is above such thresholds as the board of directors **or heads(s) of the organisation** may stipulate. |
| 5. | Maintenance of restricted / grey list | ~~**The compliance officer shall confidentially maintain a list of such securities as a "restricted list" which shall be used as the basis for approving or rejecting applications for pre-clearance of trades.**~~ | The compliance officer shall confidentially maintain a list of such securities as a "restricted list" which shall be used as the basis for approving or rejecting applications for pre- clearance of trades. |
| 6. | Pre-clearance | ▪ Prior to approving any trades, the compliance officer shall seek declarations to the effect that the applicant for pre-clearance is not in | ▪ Prior to approving any trades, the compliance officer shall seek declarations to the effect that the applicant for pre-clearance is not in |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
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| | | possession of any unpublished price sensitive information. He shall also have regard to whether any such declaration is reasonably capable of being rendered inaccurate.<br>▪ The code of conduct shall specify any reasonable timeframe, which in any event shall not be more than seven trading days, within which trades that have been pre-cleared have to be executed by the designated person, failing which fresh pre-clearance would be needed for the trades to be executed. | possession of any unpublished price sensitive information. He shall also have regard to whether any such declaration is reasonably capable of being rendered inaccurate.<br>▪ The code of conduct shall specify any reasonable timeframe, which in any event shall not be more than seven trading days, within which trades that have been pre-cleared have to be executed by the designated person, failing which fresh pre-clearance would be needed for the trades to be executed. |
| 7. | Contra-trade restriction | The code of conduct shall specify the period, which in any event shall not be less than six months, within which a designated person who is permitted to trade shall not execute a contra trade. The compliance officer may be | The code of conduct shall specify the period, which in any event shall not be less than six months, within which a designated person who **is a connected person of the listed company** and is permitted to trade in the |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
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| | | empowered to grant relaxation from strict application of such restriction for reasons to be recorded in writing provided that such relaxation does not violate these regulations. Should a contra trade be executed, inadvertently or otherwise, in violation of such a restriction, the profits from such trade shall be liable to be disgorged for remittance to the Board for credit to the Investor Protection and Education Fund administered by the Board under the Act.<br><br>Provided that this shall not be applicable for trades pursuant to exercise of stock options | securities of such listed company, shall not execute a contra trade. The compliance officer may be empowered to grant relaxation from strict application of such restriction for reasons to be recorded in writing provided that such relaxation does not violate these regulations. Should a contra trade be executed, inadvertently or otherwise, in violation of such a restriction, the profits from such trade shall be liable to be disgorged for remittance to the Board for credit to the Investor Protection and Education Fund administered by the Board under the Act.<br><br>Provided that this shall not be applicable for trades pursuant to exercise of stock options |
| 8. | Formats | The code of conduct shall stipulate such formats as the board of directors deems | The code of conduct shall stipulate such formats as the board of directors **or heads(s)** |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
|---|---|---|---|
| | | necessary for making applications for pre-clearance, reporting of trades executed, reporting of decisions not to trade after securing pre-clearance~~, recording of reasons for such decisions~~ and for reporting level of holdings in securities at such intervals as may be determined as being necessary to monitor compliance with these regulations. | **of the organisation (or committee constituted in this regard)** deems necessary for making applications for pre-clearance, reporting of trades executed, reporting of decisions not to trade after securing pre-clearance~~,~~ ~~recording of reasons for such decisions~~ and for reporting level of holdings in securities at such intervals as may be determined as being necessary to monitor compliance with these regulations. |
| 9. | Disciplinary action | Without prejudice to the power of the Board under the Act, the code of conduct shall stipulate the sanctions and disciplinary actions, including wage freeze, suspension recovery, clawback etc., that may be imposed, by the ~~persons~~ **listed company** required to formulate a code of conduct under sub-regulation (1) ~~and~~ | Without prejudice to the power of the Board under the Act, the code of conduct shall stipulate the sanctions and disciplinary actions, including wage freeze, suspension, recovery, clawback etc., that may be imposed, by the ~~persons~~ **market intermediary or fiduciaries** required to formulate a code of conduct |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
|---|---|---|---|
| | | ~~**sub-regulation (2)**~~ of regulation 9, for the contravention of the code of conduct. | under sub-regulation (1) and sub-regulation (2) of regulation 9, for the contravention of the code of conduct. |
| 10. | Disclosure to SEBI | The code of conduct shall specify that in case it is observed by the ~~**persons**~~ **listed company** required to formulate a code of conduct under sub-regulation (1) ~~**and sub-regulation (2)**~~ of regulation 9, that there has been a violation of these regulations, ~~**they**~~ **it** shall inform the Board promptly. | The code of conduct shall specify that in case it is observed by the ~~**persons**~~ **market intermediary or other entity** required to formulate a code of conduct under sub-regulation (1) or sub-regulation (2) of regulation 9**, respectively**, that there has been a violation of these regulations, ~~**they**~~ **such market intermediary or other entity** shall inform the Board promptly. |
| 11. | **Disclosure of close personal relationships and material financial relationships** | ***(New provision)***<br>**Designated persons shall be required to disclose name and PAN number or equivalent identification of the following to the company on an annual basis and as** | ***(New provision)***<br>**Designated persons shall be required to disclose name and PAN number or equivalent identification of the following to the intermediary/ fiduciary on an annual basis and as and** |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
|---|---|---|---|
| | | **and when the information changes:**<br>• **Immediate relatives**<br>• **persons with whom such designated person(s) share a material financial relationship**<br>• **persons residing at the same address as the designated persons for a consecutive period of more than one year**<br>• Phone / mobile /cell numbers which are accessible by them or whose billing address is residence address of the designated person.<br>**In addition, names of educations institutions from which designated persons have graduated from and names of their past employers shall also be** | **when the information changes:**<br>• **Immediate relatives**<br>• **persons with whom such designated person(s) share a material financial relationship**<br>• **persons residing at the same address as the designated persons for a consecutive period of more than one year**<br>• Phone / mobile /cell numbers which are accessible by them or whose billing address is residence address of the designated person.<br>**In addition, names of educations institutions from which designated persons have studied and names of their past employers shall also be disclosed on a one time basis** |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
|---|---|---|---|
| | | **disclosed on a one time basis**<br>•<br><br>**Explanation – the term "material financial relationship" shall mean** a relationship in which one person is a recipient of any kind of payment such as by way of a loan or gift) during the immediately preceding twelve months, equivalent to at least 25% of such payer's annual income but shall exclude relationships in which the payment is based on arm's length transactions. | <br><br><br><br>**Explanation – the term "material financial relationship" shall mean** a relationship in which one person is a recipient of any kind of payment such as by way of a loan or gift) during the immediately preceding twelve months, equivalent to at least 25% of such payer's annual income but shall exclude relationships in which the payment is based on arm's length transactions. |
| 12. | Indicative List of Insiders | ***(New provision)***<br>Listed companies shall have an obligation to maintain lists of persons who have access to UPSI including the names of all persons working for them | ***(New provision)***<br>Intermediaries and fiduciaries shall have an obligation to maintain lists of persons who have access to UPSI including the names of all persons |

| # | PARTICULARS | SCHEDULE B FOR LISTED COMPANY | SCHEDULE C FOR MARKET INTERMEDIARY AND FIDUCIARIES |
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| | | under a contract of employment, or otherwise, who could have access to inside information directly or indirectly.<br><br>Listed entities shall have a process for how and when people are brought 'inside' on sensitive transactions. Individuals should be made aware of the duties and responsibilities attached to the receipt of Inside Information, and the liability that attaches to misuse or unwarranted use of such information | working for them under a contract of employment, or otherwise, who could have access to inside information directly or indirectly.<br><br>Intermediaries shall have a process for how and when people are brought 'inside' on sensitive transactions. Individuals should be made aware of the duties and responsibilities attached to the receipt of Inside Information, and the liability that attaches to misuse or unwarranted use of such information |

## Annexure IV

## Amendments to Securities and Exchange Board of India Act, 1992

| SEC. | EXTANT PROVISION | PROPOSED AMENDMENTS |
|---|---|---|
| **HEADING** | **Functions of Board.** | |
| **11(2A)** | Without prejudice to the provisions contained in sub-section (2), the Board may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in section 12) which intends to get its securities listed on any recognised stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market. | Without prejudice to the provisions contained in sub-section (2), the Board may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in section 12) which intends to get its securities listed on any recognised stock exchange where the Board **has reasonable grounds to believe that such company has been ~~indulging in insider trading or fraudulent and unfair trade practices relating to securities market.~~ *involved in violation of Securities Laws.*** |
| **HEADING** | **Prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control.** | **-** |
| 12A | No person shall directly or indirectly— | - |
| | New sub-section | **(g) employ or assist in employing any device, scheme or artifice to** |

| | | |
|---|---|---|
| | | **manipulate the books of accounts or financial statement of a listed company to directly or indirectly manipulate the price of listed securities or hide the diversion, misutilization or siphoning off public issue proceeds or assets or earnings of a listed company or company proposed to be listed.** |
| **HEADING** | **Penalty for insider trading.** | |
| 15G. | If any insider who,—<br>(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information; or<br>(ii) communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or<br>(iii) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price-sensitive | If any insider who,—<br>(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange ~~on the basis~~ **while in possession** of any unpublished price-sensitive information; or<br>(ii) communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or<br>(iii) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price-sensitive information, shall be liable to a penalty which shall not be less |

| | | |
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| | information, shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher. | than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher. |
| **Heading** | **Power to grant immunity.** | Power to grant immunity **or impose lesser penalty.** |
| 24B. (1) | The Central Government may, on recommendation by the Board, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of the alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or also from the imposition of any penalty under this Act with respect to the alleged violation: | The Central Government or the **Board** may, ~~on recommendation by the Board, if the Central Government is~~ satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made thereunder, has made a full and true disclosure in respect of the alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made thereunder or **immunity** ~~also~~ from the imposition of any penalty under this Act or impose **a lesser penalty, as it may deem fit, than leviable under this Act or the rules or the regulations** with respect to the alleged violation: |

| | | |
|---|---|---|
| | Provided that no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity:<br><br>Provided further that recommendation of the Board under this sub-section shall not be binding upon the Central Government. | Provided that no such immunity shall be granted by the Central Government **or the Board** in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity:<br><br>~~Provided further that recommendation of the Board under this sub-section shall not be binding upon the Central Government.~~ |
| 24B (2) | An immunity granted to a person under sub-section (1) may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under | An immunity **or lesser penalty** granted to a person under sub-section (1) may, at any time, be withdrawn by the Central Government **or the Board**, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity **or lesser penalty** was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity **or lesser penalty** was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the |

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|---|---|---|
| | this Act to which such person would have been liable, had not such immunity been granted. | imposition of any penalty under this Act to which such person would have been liable, had not such immunity **or lesser penalty** been granted. |

## Annexure V

## Model Risk Checks for Algo Trading

**Mandatory risk checks prescribed by the SEBI and Stock Exchanges**

- Price range check
- Quantity check
- Order Value check
- Cumulative Open Order Value check
- Automated Execution check
- Trade price protection (Bad trade price)
- Market price protection (market order within the price bands)
- Net position v/s available margins
- RBI violation checks - FII restricted stocks (only for Cash)
- MWPL checks (only for FO)
- Position limits checks in FO
- Spread order Quantity and Value Limit (FO)
- Security wise User Order limit for each user ID in Cash
- Trading limits checks (Buy / Sell separate - User Order Value Limit)
- Exposure limit checks (Individual client/overall)
- User Order Value limit
- Branch value limit for each Branch ID

**Model - Circuit Breaker Check**

Price limit checks are ineffective for Market Orders by definition. Using a static reference price (e.g. Arrival-Mid) allows setting an ultimate price beyond which Algo will not participate.

Intermittent risk checks should be built in with dynamic price reference such that there is a combination of soft and hard alerts / checks which alert the Trader and require his/her attention and intervention.

**Model - Market Depth Check**

Circuit breaker checks, whilst setting an ultimate price beyond which it will not participate, still allows Algo to participate up to and including that price. This check can specifically help better control the liquidity seeking Algorithms. Generally, in this alert, a real time order book-based check is required to ensure that no single trade impacts price significantly.

Market depth checks operate to calculate how many price levels will be taken out if an order were to execute in the market. A check like Market Depth Checks should be built-in so that algorithmic orders from the Exchange are pulled out if there is not enough liquidity available up-to X% from Far Touch. Far touch is the best price on the opposite side.

**Model Last Price Tolerance (LPT) Check**

One limiting factor of market depth checks is that the Far Touch can move rapidly, taking the Market Depth Limit along with it. Last Price Tolerance check can help Algorithm from not participating at a dislocated far touch price.

A check like LPT should be built-in so that if the Far Touch moves rapidly, this check can act as an additional control.

**Model Fair Value Check**

Fair Value checks operate to prevent algorithms from following a temporary price spike by setting a secondary limit based on a short term moving average.

A check like this should be built in so that when exceptional volumes have trades either due to a large block/fat finger error in split seconds (fractions of second), Fair Value Check will help cancel the noise and further unintended cascading effect.