

Discussion Paper on amendment to the SEBI (Prohibition of Insider Trading) Regulations, 2015 to provision for an informant mechanism.

INTRODUCTION:

1. Insider trading is defined in the SEBI (Prohibition of Insider Trading) Regulations, 2015 ('PIT Regulations') to mean trading of securities while in possession of unpublished price sensitive information ('UPSI'). Insiders usually indulge in insider trading through a proxy to whom the relevant information is communicated. Direct evidence of such communication is seldom available across various jurisdictions, Thus detection and prosecution of insider trading remains a challenge. Like other securities market regulators across the world, SEBI also faces this challenge in checking instances of insider trading violations primarily due to the insufficiency of evidence of commission of the violation.
2. The mandate of the SEBI Act, 1992 is to 'protect the interests of investors in securities and to promote the development of, and to regulate the securities market.' It thus becomes imperative for SEBI to employ all legitimate means to detect and initiate action against insider trading at the earliest to instil confidence amongst investors and ensure integrity of the securities markets in line with the mandate conferred upon it.

NEED FOR AN INFORMANT REWARD POLICY FOR INSIDER TRADING CASES:

3. Direct evidence of insider trading is not easily available and that which is generally available is almost completely circumstantial. Since criminal law requires proof to be established beyond reasonable doubt, it is a challenge for SEBI to successfully prosecute such cases.

4. While investigating cases pertaining to insider trading, the challenges faced by SEBI include,-
 - i. Establishing transmission of UPSI and proving flow of such information,
 - ii. Absence of details relating to UPSI, such as the precise time when the information was generated and when it became public and the people who had access to it before it became public,
 - iii. Identification of connection or relation between insiders and those who traded based on the UPSI,
 - iv. Acquiring evidence for establishing connections
 - v. Establishing that trading took place while in possession of UPSI

These challenges could result in the investigation in insider trading cases taking a longer time for completion as opposed to cases pertaining to other kinds of market manipulation.

5. Many cases of violations are brought to public attention, not necessarily through any audit report or regulatory investigation but largely through revelations by an insider or in the rarest of rare cases, through self-admission. Since company employees are likely to be acquainted with the devilry of the management or the promoters, certain routes need to be established through which such irregularities may be exposed. Simultaneously, companies also need to ensure that there is an easy and a smooth route to raise such concerns or else the workforce could also become silent perpetrators, when the issues become public.

6. Information provided by persons who may have inside knowledge of such violations is often helpful in timely successful action against violators. Recently, the Committee on Fair Market Conduct has made several recommendations to strengthen the legal framework for prevention of insider trading. The recommendations have been appropriately implemented by amending the PIT Regulations.
7. As a further step towards strengthening the mechanism for early detection of insider trading and better enforceability, it is desirable and prudent that SEBI considers instituting a process that enables timely reporting of instances of insider trading violations and also provide for grant of reward with adequate checks and balances that could incentivize timely reporting of information relating to insider trading to SEBI at the first available opportunity.
8. Hence a mechanism which also provides '*near absolute confidentiality*' along with appropriate safeguards is also proposed to enable reporting of such information.

INGREDIENTS OF AN EFFECTIVE INFORMANT MECHANISM:

9. Informant incentivisation and protection programmes are considered as effective means to expose and remedy fraud and other types of wrongdoing in the public and private sectors. However, such a policy should provide for the following objectives:
 - i. A dedicated reporting window for any person who observes an unethical behaviour; actual or suspected violation of insider trading cases;
 - ii. Processes in place that encourage:
 - a. timely, safe and open reporting of alleged violation; and
 - b. consistent and timely institutional response;
 - iii. Policies in place that:
 - a. incentivize informant protection;
 - b. encourage ethical and lawful conduct; and
 - c. provide adequate safeguards against victimization of informant.

IMPORTANCE OF AN EFFECTIVE INFORMANT POLICY:

10. One of the challenges in procuring information on potential insider trading violations would be dealing with complaints made through non-official channels by unscrupulous or interested persons. Keeping in mind the above, a formalized process of receiving information which provides for a reporting mechanism for violations relating to insider trading and incentivizing and protecting informants who report information, useful for detecting such violations of PIT Regulations, would not only instil confidence in the market but also incentivise informants to pro-actively report such issues to SEBI.
11. Such a formal informant mechanism would:
 - i. enable SEBI to factor such genuine complaints;
 - ii. strengthen the enforcement mechanism in SEBI ;
 - iii. conserve and provide for efficient utilization of resources of SEBI;
 - iv. streamline a mechanism to weed out frivolous or false complaints; and
 - v. strengthen the surveillance activities of SEBI.

FEATURES OF THE PROPOSED MECHANISM UNDER THE SEBI (PIT) REGULATIONS, 2015:

12. The proposed amendments to PIT Regulations would include the following features, namely:
 - i. **VOLUNTARY INFORMATION DISCLOSURE FORM:** Informant means any individual(s) who voluntarily submits a Voluntary Information Disclosure Form (VIDF) detailing credible, complete and original information relating to an act of insider trading, including communication of unpublished price sensitive information or trading in violation of the code of conduct requirements under the PIT Regulations that has occurred/ is occurring/ has a reasonable belief that it is about to occur.
 - ii. **DISCLOSURE OF SOURCE OF INFORMATION:** It shall be mandatory for an informant to disclose the source of original information and to provide an undertaking that the original information provided has not been sourced from any person employed with

SEBI or any related regulator. An indemnity clause to that effect shall also form part of the undertaking which shall be signed by the informant.

- iii. **OFFICE OF INFORMANT PROTECTION ('OIP')**: An independent office separate from the investigation and inspection wings or any of the dealing departments may be established by the SEBI to devise the policy relating to receipt and registration of VIDF, processing the veracity and authenticity of the information received, analysing the application of regulations and thereafter deciding upon the issue of grant of reward to the informant upon completion of enforcement action by the Board and recovery of amounts by way of disgorgement. The OIP would serve as a medium of exchange between the informant/legal representative and the Board.
- iv. **MANNER OF SUBMISSION OF INFORMATION**: The informant would need to disclose his/her identity at the time of submission of the VIDF. In case the informant decides to submit anonymously, the VIDF shall be submitted through an authorised representative who is a practising advocate. An informant who directly submits the VIDF may be required to appear in person before the Office of Informant Protection (OIP) at SEBI's Head Office in Mumbai for ascertainment of his/her identity and the veracity of the information so provided.
- v. **CONFIDENTIALITY OF INFORMANT**: The confidentiality regarding the identity of the informant and information provided shall be protected through the OIP and shall be maintained throughout as well as during any proceeding initiated by SEBI except where the evidence of the informant is required during such proceedings.
- vi. **OBLIGATIONS OF LEGAL REPRESENTATIVE**: The legal representative shall be required to *inter alia* verify the identity and contact details of the Informant and also ensure that the identity of the Informant along with the original VIDF is kept confidential. The identity of the Informant would be required to be revealed only if SEBI makes a request for the original VIDF *inter alia* for the following reasons:
 - a. When the Informant has not complied with the given regulations/guidance;
 - b. When the nature of the information provided, requires the informant to be examined;
 - c. When it is required to be disclosed in connection with any court proceedings; or
 - d. When SEBI requires the said information for verification at the time of granting the gratuitous reward in favour of the informant.

Hence a non-waivable consent needs to be obtained by the legal representative from the Informant as provided in the VIDF.

- vii. **PROCESSING OF INFORMATION:** The original Information shall be processed by the OIP after establishing the materiality of the information. The OIP may transfer such information to the operational department only after excising any information which may have the effect of revealing the identity of the Informant. The dealing departments in SEBI shall further process the original information to recommend any suitable enforcement actions including issuance of administrative warnings, directions under the SEBI Act, 1992, imposition of penalty or prosecution on a case to case basis.
- viii. **REPORTING:** OIP shall submit a Report regarding its functioning and working of the informant policy regulations on an annual basis to the Board, which shall also be released to the public.
- ix. **HOTLINE:** A hotline shall be maintained by the OIP to guide persons to file information as per the regulations but not to register any complaint or information. The hotline would thus serve as a process to facilitate submission of information by the informant.
- x. **GRANT OF REWARD:** The concept of reward may be considered under this policy in the form of a gratuitous monetary amount in case the information is provided in compliance with the informant policy and monies are disgorged as a result of any action taken on the basis of true, credible, complete and original information, and leads to a disgorgement of atleast Rupees five (5) crore.
QUANTUM OF REWARD: The total amount of monetary reward shall be [10 %] of the monies collected but shall not exceed Rs one (1) crore or such higher amount as may be specified. An interim reward not exceeding Rs. 10 lacs may be given at the stage of issuance of the final order by the SEBI against the person directed to disgorge. The final reward, after adjusting the interim reward, shall be issued after collection or recovery of the monies disgorged equal atleast twice the final reward.
- xi. **INVESTOR PROTECTION AND EDUCATION FUND ('IPEF'):** IPEF shall be the designated fund from which the reward is to be paid. Since the proceeds of the disgorgement order are deposited in the IPEF; legal sanctity would be attached to the disbursement of rewards from IPEF.
- xii. **SHARING OF INFORMATION:** The original information may be shared with an appropriate regulatory or law enforcement authority within or outside India or a

self-regulatory organisation, subject to the discretion of SEBI, keeping in view the objectives of the SEBI Act. Unless the circumstances necessitate otherwise, the identity of the informant shall be maintained even while sharing this information.

- xiii. **EXEMPTION UNDER RTI:** Information provided for the purpose of law enforcement is exempted from disclosure under section 8(1)(g) and 8(1)(h) of the Right to Information Act, 2005. Accordingly, the original information provided by the informant under this policy shall be exempted from disclosure.
- xiv. **PROTECTION AGAINST VICTIMIZATION:** Every person associated with the securities markets, including listed companies and intermediaries, dealing with UPSI, shall respectively incorporate in their Code of Conduct, suitable provisions to ensure that no employee who files a VIDF is discharged, terminated, demoted, suspended, threatened, harassed, or discriminated against, directly or indirectly for breaching the provisions of any terms and conditions of employment such as a confidentiality agreement, merely on account of filing such VIDF or assisting the OIP of SEBI under this policy. Any violation of the provisions of the Code of Conduct may result in the levy of penalties, order of debarment or prosecution proceedings or any other appropriate action under the securities laws.
- xv. **VEXATIOUS/FRIVOLOUS COMPLAINTS:** In case the OIP determines that the information submitted is frivolous or vexatious, SEBI may initiate appropriate action against the informant under the securities laws and any other applicable law.
- xvi. **AMNESTY:**
 - i. While bringing an action against an Informant, SEBI may consider the cooperation rendered in determining any enforcement action or settlement application filed by him/her;
 - ii. In cases where proceedings have been initiated against the informant, SEBI may declare such a person eligible for a reward after the Informant has paid any monetary sanctions ordered against him/her or complied with the directions issued to him.
 - iii. An informant who is culpable but voluntarily co-operates and assists SEBI may be eligible for reward under this scheme and shall also be eligible for settlement with confidentiality in the proceedings that may be initiated against him. This shall however not prohibit initiation of action for any misconduct.

13. The proposed policy is proposed to be brought into force by suitably amending the SEBI (Prohibition of Insider Trading) Regulations, 2015 with prospective effect, preferably from the 100th day from the date of notification of the amendments to the PIT Regulations. This would allow the market participants to be conversant with the requirement of reporting mechanism and simultaneously enable the creation of necessary systems within SEBI.

PUBLIC COMMENTS:

Considering the implications of this policy on various stakeholders; public comments on the proposal to have such a mechanism are solicited.

The comments/ suggestions, if any, may be provided as per the format given below:

Name of the individual:			
Name of organization (if applicable):			
Contact details:			
Sr. No.	Relevant suggestion/point	Proposed/ suggested changes	Rationale

Such comments/suggestions, if any, may be e-mailed to sebilad-dop@sebi.gov.in or sent by post at the following address latest by **01.07.2019**.

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