

## ERGO

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### APPLICABILITY OF PIT REGULATIONS TO MUTUAL FUNDS

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#### **Introduction**

The Securities Exchange Board of India (SEBI) released a consultation paper on 8 July 2022 proposing applicability of SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations) to 'units of a mutual fund' (hereinafter "the Consultation Paper"). The PIT Regulations currently apply to dealings in 'securities' of listed / to be listed entities. It will be recalled that the definition of 'securities' in the PIT Regulations specifically excludes 'units of a mutual fund'. This proposed extension of the PIT Regulations will be a major development in the securities laws.

#### **Rationale**

The Consultation Paper states that the need for the amendment to the PIT Regulations has emerged from specific incidences of misuse of Unpublished Price Sensitive Information (UPSI) by certain key personnel / registrar and transfer agents who as insiders holding the units of the scheme redeemed them before information was communicated to the other unitholders by the mutual fund.

SEBI had attempted to address such situations in the past through circulars emphasizing that employees, board members of Asset Management Company (AMC) and trustees of the fund etc. shall not transact in any units of the scheme(s) while in possession of UPSI. The circulars also introduced the concept of "Access Persons" or such persons who by virtue of their fiduciary capacity may take undue advantage of UPSI in their possession while dealing in mutual funds.

The Consultation Paper proposes the insertion of a separate chapter in the PIT Regulations which will apply exclusively to mutual funds. This proposed insertion will achieve the purpose of regulating the trades by employees of AMCs / trustees in units of own mutual fund as well as prescribing similar requirements for the persons with whom the information relating to mutual fund schemes is shared for legitimate purpose.

#### **Overview**

Altered definitions specifically applicable to mutual fund units:

- Presently, 'securities' as defined in the PIT Regulations specifically excludes 'units of a mutual fund'. The altered definition will remove this exclusion thereby extending the application of the PIT Regulations to 'units of a mutual fund'.
- The definition of 'trading' is proposed to be amended to include "redemption, switching or agreeing to redeem or switch securities". This addition will bring insider trading activities unique to mutual funds within the ambit of PIT Regulations.
- UPSI with respect to mutual fund is broadly defined as any information pertaining to a scheme of a mutual fund which is not yet generally available, and which could

materially impact the Net Asset Value or materially affect the interest of unit holders.

- 'Generally Available Information' with respect to mutual fund has been qualified to information that is made available to the unitholders or made accessible to the public on a non-discriminatory basis on an independent platform(s) as specified by SEBI, including the platform of the stock exchanges.
- The Consultation Paper proposes to have separate definitions and varied concepts of 'Designated Person' and 'Connected Person' which have been defined taking into consideration the types of persons who are privy to UPSI of the 'units of a mutual fund'. 'Connected Person' has been defined very broadly as any person who is or has during the two months prior to the concerned act been associated with the Mutual Fund, AMC and Trustees, directly or indirectly in any capacity. Whereas, a 'Designated Person' has been defined to include a prescribed list of persons including key personnel of AMC, Trustee Company, Research Analysts, and head of all divisions.

#### Other salient features:

- The following defenses would be available to an insider for proving his / her innocence:
  - the transaction was an off-market inter-se transfer between insiders possessing same UPSI who made an informed decision;
  - the transaction was carried out pursuant to a statutory or regulatory obligation including subscription / investment in mutual fund units pursuant to mandatory requirement prescribed by SEBI vide circular number SEBI/HO/IMD/IMD-I/DOF5/P/CIR/2021/553 dated 28 April 2021; and/or
  - the transaction was triggered by systemic plans or irrevocable trading plans subject to certain additional requirements. Provided the trading period for each plan shall be at least six months with no overlap between different trade plans.
- The AMC will be required to disclose on an independent platform, the details of holdings in the units of the mutual fund schemes held by the Designated Persons of AMC / Trustees, their immediate relatives and any other person for whom such person takes trading decisions.
- Designated Persons of AMC / Trustees, their immediate relatives and any other person for whom such person takes trading decisions shall report details of all transactions in mutual fund units to the Compliance Officer of AMC within 7 (seven) calendar days from the date of transaction. Further, those transaction that have a value above rupees ten lakhs are to be disclosed by the AMC on an independent platform as decided by SEBI within 48 (forty-eight) hours of receipt of the same.
- The mutual funds will be required to adopt a separate code of conduct for Designated persons and others handling UPSI with respect to mutual fund.
- Compliance officer of AMC will be authorized to determine the closure period during which a 'Designated Person' or class of 'Designated Persons', who can reasonably be expected to have possession of UPSI, their immediate relatives and any other person for whom such person takes trading decisions cannot transact in mutual fund units.

#### **Comment**

While regulating insider trading in relation to 'units of a mutual fund' is a welcome step, a few questions emerge in relation to the architecture of the proposal:

- Whether the extensive regulatory framework will be effective as part of PIT Regulations or whether it would be more suitable to have it as part of the SEBI (Mutual Fund) Regulations, 1996.

- Whether the PIT Regulations on mutual funds will govern unlisted entities. As such, while the framework provides for a closure period, it is unclear how this concept will impact unlisted mutual fund units.
- Considering 'redemption' and 'switch' are off market transactions, a grey area arises by including them in the definition of trading and at the same time providing a defense for off-market transactions.
- Clarity is needed on how the concept of 'contra trade' will apply to redemption of a unit.
- There is ambiguity whether the PIT Regulations will now regulate securities which are held as underlying the portfolio through the mutual fund units.
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