

SEBI Exemption: Possession of UPSI & trading window closure no longer applicable for debt securities

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Introduction

The Securities and Exchange Board of India (SEBI), *vide* circular number SEBI/HO/ISD/ISD-PoD-2/P/CIR/2024/180 dated 30 December 2024 (Circular) relaxed the applicability of trading window restrictions prescribed under schedule B paragraph 4 of the SEBI (Prohibition on Insider Trading) Regulations, 2015 (PIT Regulations) in relation to subscription to non-convertible securities, as defined under Regulation 2(x) of the Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (SEBI NCS Regulations), as amended. This Circular follows SEBI's consultation paper dated 26 September 2024, which sought public comments on the proposal to exempt certain transactions from trading window restrictions.

Through the Circular, SEBI has allowed market participants to subscribe to the non-convertible securities of a listed entity without being constrained by the closure of trading window restrictions. The term 'Non-Convertible Securities' is defined under SEBI NCS Regulations to include debt securities, non-convertible redeemable preference shares, perpetual non-cumulative preference shares, perpetual debt instruments and any other securities as specified by SEBI.

Trading window restrictions

PIT Regulations have been put in place to prevent insider trading and ensure fair market practices. Through the PIT Regulations, SEBI prohibits trading of securities of a listed entity for a period, when the holders of such securities are in possession of unpublished price sensitive information (UPSI), which, upon becoming generally available, is likely to affect the price of the securities.

The trading window refers to specific periods during which insiders of a company are allowed to trade in the company's securities. PIT Regulations restrict trading of securities of a listed entity outside the trading window period to prevent the misuse of UPSI and gaining an unfair advantage which will benefit person in possession of UPSI at the expense of persons who are not in possession of UPSI.

Applicability of the Trading Window restrictions

The closure of trading window is applicable: (i) when the compliance officer of a listed entity determines that a designated person(s) and their immediate relatives (collectively "DP") or a class of DPs could reasonably be expected to be in possession of UPSI in relation to securities of such listed entity until such information becomes public; and (ii) from the end of every financial quarter till 48 hours after declaration of financial results by the listed entity.

The existing PIT Regulations provide certain relaxations to the trading window closure restrictions to facilitate certain specific transactions. These relaxations are outlined in Clause 4(3)(b) of Schedule B and Regulation 9(1) of the PIT Regulations. The trading window restrictions do not apply to the following transactions:

1. acquisition by conversion of warrants or debentures;

2. subscription to rights issue;
3. further public issue;
4. preferential allotment; and
5. tendering of shares in a buy-back offer, open offer, or delisting offer.

In addition to the aforementioned transactions, SEBI, through its circular dated 23 July 2020, extended the relaxations from the closure of trading window restrictions to include offer for sale and rights entitlement transactions. These exemptions are designed to ensure that legitimate corporate actions and capital-raising activities are not hindered by the trading window restrictions.

Analysis

Following are the reasons considered by SEBI for relaxation of the trading window restrictions on non-convertible securities:

1. Parity of information principle

The PIT Regulations have been formulated basis the 'parity of information' principle. This theory is a fairness-based doctrine centred on the idea that trading on informational advantages undermines investor confidence and the integrity of capital markets. It is for this reason that in cases where parties have UPSI, but no information asymmetry exists, insider trading norms are not applicable.

In contrast, debt securities are issued at a pre-determined coupon rate and for a fixed face value. This is generally decided at the time of issuance of the debt securities. As a result, debt securities are treated as fixed income securities and once the coupon and price are fixed, the debt securities are generally traded at a pre-determined price. As a result, there is little scope for an insider to leverage UPSI in such cases at the time of subscription and/or transfer of the debt securities. Accordingly, possession of UPSI does not provide holders of debt securities with an opportunity to gain any unfair advantage on basis of UPSI.

2. Price fluctuation not possible for debt securities

The guiding principle for application of the PIT Regulations to any kind of security is the amenability of such security to price fluctuation on a market platform. Accordingly, if the price of a security will not fluctuate through the inter-play of demand and supply, an insider cannot utilise the UPSI to gain an unfair advantage over others who lack such information.

The price of a debt security is generally not subject to the forces of demand and supply. Rather, the price is set transparently by the issuer at the time of issuance of the debt security. As a result, the impact on the price of a debt security is not determined by the interplay of market forces and therefore a debt security will not be amenable to insider trading.

3. Hold till maturity and low trading volumes

Debt securities are generally held-till-maturity, which means that these are not frequently traded in the secondary debt market. This is seen from the relatively low trading volumes of debt securities as compared to the equity market.

Accordingly, even if an investor is in possession of UPSI, the chances of the investor utilising such UPSI to create an unfair advantage is little to none since most of the investors hold debt securities till maturity.

4. No future and options market segment in NCS

Unlike the equity segment, debt securities do not have a future or options market. In a futures market, the buyer and seller enter into a binding agreement to buy or sell an asset at a fixed price. Both parties are obligated to follow up on the contract. In options market, on the other hand, the buyer has a right, not an obligation, to buy the asset back at the pre-determined rate. In the absence of such market segments (as also the absence of demand supply factor in determining price), market manipulation using UPSI by an insider becomes less likely.

Comments

In conclusion, the Circular represents a progressive step towards enhancing market efficiency and providing greater flexibility to market participants. The Circular is geared towards incentivising prospective issuers and subscribers to the non-convertible securities and improving liquidity in the secondary market for non-convertible securities. Further, the Circular aligns with global best practices and reinforces SEBI's commitment in fostering a robust and transparent securities market in India.

However, though being a progressive step, the Circular is not clear on the applicability of closure of trading window restrictions over trading of debt securities of Indian issuers listed on offshore stock exchanges. This ambiguity needs to be addressed to ensure comprehensive regulatory clarity and to avoid potential compliance issues for market participants involved in international debt transactions.

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