

NEW INSIDER TRADING REGULATIONS: RESTRICTIONS ON ESOPs

Introduction

With effect from May 15, 2015, the new insider trading regulations, notified by the Securities and Exchange Board of India (“**SEBI**”) have come into force. The SEBI (Prohibition of Insider Trading) Regulations, 2015 (“**New Regulations**”) will replace the SEBI (Prohibition of Insider Trading) Regulations, 1992 (“**1992 Regulations**”).

While the New Regulations can be considered as progressive, SEBI is facing criticism for the restrictions imposed by the New Regulations on exercise of employee stock options (“**ESOPs**”) by employees of listed companies.

Restrictions on Exercise of ESOPs

As per the New Regulations, no ‘insider’ shall ‘trade’ in securities of the company, when in possession of unpublished price sensitive information (“**UPSI**”). UPSI has been defined to include any information relating to: (i) financial results of the company; (ii) dividends; (iii) change in capital structure; (iv) mergers, de-mergers, acquisitions, delisting, disposals and expansion of business and such other transactions; (v) changes in key managerial personnel; and (vi) material events as per the Listing Agreement. The definition of ‘Insider’ includes directors, officers and employees of the company. As a result, among others, no officer or employee of a company may trade in securities when he may actually possess or due to his role is expected to possess UPSI.

In practice, when an event or transaction involving UPSI is under consideration (“**UPSI Event**”), the compliance officer of the company declares closure of the trading window for designated employees of the company. The window closure period usually continues till 48 (forty eight) hours* after the disclosure of UPSI on stock exchanges.

While restrictions stated above were imposed even by the 1992 Regulations, an exception for exercise of ESOPs was provided under Clause 3.2-6 of the Model Code of Conduct. Pursuant to the exception, employees could convert their stock options into shares, even during window closure periods. As no such exception is available under the New Regulations, exercise of ESOPs during window closure period shall now be treated as Insider Trading.

*IL Comment: Post disclosure, non-trading period was 24 (twenty four) hours under the 1992 Regulations.

Such a change will also affect the marketability of ESOPs per se, as frequency of UPSI Events leave little window for an employee to exercise his ESOPs. For example, the trading window closure period for declaration of financial results, stretches up to 45 (forty five) days from the end of each quarter. Therefore, a designated employee cannot exercise his stock options, for almost 188 (one hundred and eighty eight) days in a year. Further, there is lack of clarity on whether the exemption for trading in converted shares and fresh issuance of ESOPs, within the restricted period of 6 (six) months, would still be available.

IndusLaw Quick View:

Stock options are usually used by companies as incentives, to be granted to its preferred employees. The changes introduced by the New Regulations do little to keep employees interested in such instruments. While regulatory intervention can permanently cure the situation, listed companies, at this stage, will have to take preventive steps.

Employees of listed companies are therefore advised to explore the new option of submitting trading plans with the compliance officers. Such a submission of the trading plan will allow the employees to implement their pre-decided ESOP trades without any threat of indictment. But, the employees will be able to commence trading only after six months from public disclosure of such plan. Further, the inability to amend the trading plan will restrict the trading options available to employees. Thus, listed companies themselves will have to take lead in educating their employees and compliance teams, to avoid any collateral damage.

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