



**Consultative Paper
on introduction of
'Short Swing Profit' regulations in India**

1st January 2008

1. With a view towards incorporating an additional corporate governance measure which aligns the interests of a company's shareholders to that of the company's insiders, additional regulations are proposed to be introduced in the SEBI (Prohibition of Insider Trading) Regulations 1992 (**the regulations**). The proposed regulation seeks to compel an 'insider' to surrender such profits to the company in any of his/her transaction concerning equity based securities of the company (including its parents or subsidiary's shares) in the event both the buy and sell side of the transaction are entered into within six months of the other. A similar concept is captured in Section 16(b) of the Securities Exchange Act of 1934 (of the United States), which requires ten percent owners, directors and officers of a company to give up "any profit realized ... from any purchase and sale, or any sale and purchase, of any equity security" of the company within a six-month period.
2. Such a Regulation will check insiders, who have greater access to price sensitive company information, from taking advantage of information for the purpose of making short-term profits (short swing profits). It is assumed that insiders have a long term investment in the company and are not expected to make rapid buy/sell transactions, which are assumedly based on at least some level of superior access to information, whether material or not. Additionally, as

mentioned above, it will align the long term objectives of company insiders with the company shareholders.

3. Further, it is proposed that the “Last In First Out” (LIFO) method be adopted for determining the six month period between trades.
4. Liability will be imposed without any necessity for guilt or wrongfulness and conversely a direction to surrender profits made in a short swing transaction shall not necessarily imply any form of guilt. The surrender of profits made in such short swing transactions shall be automatically imposed as a part of good corporate governance requirement. The short swing rule will get automatically attracted as soon as two things are established. First is the fact of being an insider or a “designated insider” (which is elaborated below). And second, the fact that the same securities were bought and sold within six months of each other. In such a regulation, the intent of the person shall be immaterial. Merely the fact of the trade will be sufficient to take action i.e. direction to make over such profits to the company. Where there is a delay, interest may be payable by such insider to the company.
5. Additionally, there are two possible approaches with regard to the constituent insiders captured within the ambit of short swing regulations. The concept of a “designated insider” may be considered for the purpose of surrender of short swing profits and it is intended to be narrower than the existing concept of what constitutes a deemed insider and broader than what is known as an insider under the present regulations. It is proposed that “designated insider” should capture within its ambit all key management personnel by whatever name called, all directors of the company, all officers of the company who are the beneficial owners, directly or indirectly, of ten percent or more of any class of equity securities (“ten percent owner”). Alternatively, all officers of the company as well

as all beneficial owners of the company in excess of 10% holding, singly or in concert, would also be implicated in the definition of designated insider.

6. It is proposed that there shall be an exemption of certain transactions from amounting to transactions resulting in short swing profits (subject to conditions) such as: transactions approved by a regulatory authority, employee benefit plans, *bona fide* gifts and inheritances, mergers and acquisitions etc. Certain securities may also be considered as exempt altogether.
7. Comments are invited from the public on the consultative paper particularly with regard to a) coverage of persons in the definition of 'designated insider' b) method of calculating the dates of purchase and sale c) classes of exemptions. The comments may be sent by e-mail up to January 21, 2008 to the following addresses –

vidishak@sebi.gov.in (Ms. Vidisha Krishan)

Comments may also be sent physically to the following address, so as to reach latest by January 21, 2008 – **Ms. Vidisha Krishan, Legal Officer, Legal Affairs Department, Securities and Exchange Board of India, SEBI Bhavan, C-4A, G-Block, Bandra Kurla Complex, Mumbai – 400051.**