Curbing Mutual Fund Insider Trading

Why in news?

The SEBI's consultation paper has proposed to add specific provisions to the Prohibition of Insider Trading Regulations to prevent insider trading in mutual fund units.

What issues were pointed in the consultation paper?

> *Insider trading is the buying or selling of a publicly traded company's stock by someone who has non-public, material information about that stock.*

- There have been recent instances of top AMC executives cashing out of funds ahead of adverse events that affected the value for public unitholders (the Franklin Templeton case).
- In many situations, insiders with access to unpublished information avoid losses or make unfair profits.
- MF insiders can get wind of redemption pressures, liquidity issues, fund manager exits and entries, and governance lapses or regulatory investigations ahead of others and act on such information.

What has the consultation paper proposed?

- The consultation paper proposes tightening the screws on MF insider trading.
- **Declaring the closure period** - It wants AMCs, like corporates, to declare a closure period ahead of specified material events during which designated AMC officials cannot buy or sell their own schemes.
- Closure period is the period when employees are in possession of a sensitive information like change in investment objective, material change in valuation of assets, conversion of an open-ended scheme to a closed ended scheme or vice-versa.
- **Expansion of "connected persons"**- The current SEBI curbs on units possessing unpublished price sensitive information (UPSI) apply only to AMC employees while the new rules seek to extend the curbs to a range of 'connected' outsiders.
- 'Connected persons' have been defined to include employees of the sponsor and trustees of AMCs, fund registrars, fund accountants, AMFI officials, auditors, bankers and legal advisors.
- Any person who has been in frequent contact with an AMC, its sponsor or trustees in the two months prior to a material event, will also be deemed a 'connected person'.
- **Charging fund insiders**- SEBI proposes charging fund insiders and others they deal with a fiduciary duty to not share UPSI, except for legitimate purposes.
- Any contravention of this provision should attract the stringent penalty clauses of the Prohibition of Insider Trading Regulations.

What are the concerns with the consultation paper?

- **Broad and overlapping**- The proposal has drawn some criticism from market participants for being too broad in scope and overlapping extant circulars.
- **Reduction of opportunities**- Requiring MFs to share all price-sensitive information relating to their schemes or the AMC immediately on a public platform can reduce opportunities for MF insider trading.

What is the way forward?

- While SEBI can go ahead with these proposals after factoring in stakeholder feedback, tighter insider trading laws for mutual funds must perhaps go hand-in-hand with a stricter material disclosure regime for AMCs.
- SEBI must co-ordinate with AMFI to devise a centralised online platform where AMCs disclose all material information affecting unitholder interest in a timebound manner.

References

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