

Analyzing SEBI's paper on rewarding whistleblowers

The Securities and Exchange Board of India (SEBI) faces numerous challenges in investigating and determining insider trading violations. Lack of direct or conclusive evidence of violations is a key challenge in most cases. On 10 June 2019, SEBI issued a discussion paper on a proposed informant mechanism under which whistleblowers will be rewarded for reporting instances of insider trading.

The mechanism described in the discussion paper appears to be inspired by the whistleblower framework under the US Dodd-Frank Wall Street Reform and Consumer Protection Act, which authorizes the US Securities and Exchange Commission to provide monetary rewards to individuals who voluntarily provide original information that leads to successful enforcement action. Under SEBI's proposed informant mechanism:

- An informant will be able to provide information on insider trading to SEBI by submitting a voluntary information disclosure form (VIDF), personally or anonymously (through a legal representative). The informant will need to provide an undertaking that the information provided has not been sourced from an employee of a regulator (including SEBI) and provide an indemnity to this effect.
- SEBI will set up an Office of Informant Protection (OIP), which will be independent of the investigation and inspection wings, as a medium of exchange between the informant and SEBI.
- Subject to certain exceptions, the identity of the informant and the information provided will be maintained with near absolute confidentiality with appropriate safeguards.
- Listed companies will be required to revise their internal code of conduct to ensure that employees are not terminated, demoted, suspended, threatened, harassed, or discriminated against, directly or indirectly, because they submitted a VIDF.
- If the information is provided in compliance with the informant policy and at least ₹50 million (US\$706,775) is disgorged as a result of action taken on the basis of credible, complete and original information, the informant may receive a reward equal to 10% of the monies collected, but not exceeding ₹10 million, or a higher amount as may be specified.
- If the OIP determines that the information submitted is frivolous or vexatious, SEBI may initiate appropriate action against the informant under the applicable law; and
- SEBI may grant amnesty from regulatory action to certain informants.

The introduction of an informant mechanism is a step in the right direction. However, the success of this mechanism depends on several factors, including how it is implemented. Certain key areas which may need to be considered further are as follows:

- **Frivolous complaints:** The discussion paper states that if a complaint is found to be frivolous or vexatious, SEBI may initiate appropriate action against the informant. However, SEBI would need to formulate an effective procedure to deal with frivolous complaints to prevent misuse. SEBI may need to

deploy additional resources to determine the veracity of such complaints.

- **Confidentiality:** Maintaining confidentiality is the first element of a whistleblower protection system. SEBI can, however, share the information with an appropriate regulatory or law enforcement authority within or outside India or a self-regulatory organization. The informant is likely to be a witness in SEBI proceedings. These factors may disincentivize the usage of the informant mechanism. The obligation of the legal representative in case of anonymous complaints is not clear from the discussion paper.
- **Internal whistleblower policies:** Currently, whistleblower complaints are based on the internal code of conduct that listed companies are required to formulate under applicable laws. SEBI may need to clarify the interplay between the internal code of conduct and the proposed informant mechanism to avoid confusion in the process to be followed for complaints by whistleblowers. Additionally, SEBI should consider whether a complaint to an internal compliance committee framed under a code of conduct should be considered for reward and amnesty provisions under the informant mechanism.

In the last few years, several cases have come to light because of whistleblowers across different jurisdictions. While the proposed informant mechanism is currently limited to insider trading cases, once implemented, depending on the benefits of the mechanism, SEBI could consider extending it to cases of fraud and unfair trade practices.

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