

Information sharing under SEBI's insider trading rules

The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 (PITR), prohibits communication of unpublished price sensitive information (UPSI) to any person except where it is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

A company may provide access to UPSI if its board is of the informed opinion that a proposed transaction is in the company's best interest. However, if it is not an open offer transaction, UPSI is to be made generally available at least two trading days prior to the proposed transaction being effected. Practical issues in this regard include determining company's best interests and timing and content of cleansing announcements. PITR also does not expressly legislate against "market sounding", i.e. communication of information to gauge interest of potential investors.

The Securities and Exchange Board of India (SEBI) has issued amendments to PITR effective from 1 April 2019, which accept the recommendations of the Fair Market Conduct Committee, and which require boards of listed companies and intermediaries to define their own policy relating to "legitimate purposes", and determine if sharing of UPSI for due diligence (instead of the proposed transaction itself) is in the company's best interest. For illustrative purposes, "legitimate purposes" is defined as including sharing of UPSI in the ordinary course of business with inter alia lenders, customers and legal advisors. Companies will be required to maintain a digital database of UPSI recipients with adequate internal controls.

An October 2017 report by the Committee on Corporate Governance stated that strategic transactions often require the support of promoters, who are generally subject to greater responsibility under the law, and significant shareholders (such as PE investors), who are permitted information rights through nominee directors. While it is recognized that promoters are akin to perpetual insiders, information flow to promoters and significant shareholders "occurs in the 'shadows' in the absence of a green channel" legitimizing it.

Accordingly, the committee proposed amendments to the listing regulations to enable sharing of information with promoters and shareholders with nominee directors, including execution of an "access to information agreement" setting out confidentiality obligations and undertakings by the recipient and the rights of the company to withhold access to material information under specified circumstances.

SEBI, however, rejected it stating, "giving any shareholder preferential treatment compared to other shareholders for getting access to information has far reaching implications and therefore may not be desirable".

Under the EU's Market Abuse Regulation, a company may delay public disclosure of inside information provided that immediate disclosure is likely to prejudice its legitimate interests, delay of disclosure is not likely to mislead the public and it is able to ensure confidentiality of the information. While "legitimate interest" is not defined, an illustrative list issued by the European Securities and Markets Authority (ESMA) includes mergers, acquisitions and so on. Inside information can be disclosed to selected persons who owe a duty of confidentiality and require it to perform their functions, such as major shareholders and persons with whom the company is negotiating transactions. ESMA has also issued practical guidance for market

sounding, which is useful in case of capital raising.

In the US, Regulation FD (Fair Disclosure) does not prohibit private communication between a company's director and shareholder(s) provided the director does not disclose material non-public information to such shareholder(s) where it is reasonably foreseeable that the shareholder(s) will trade the company's securities on the basis of such information. Private communication between an independent director and shareholder(s) is also not prohibited if the shareholder(s) expressly agrees to confidentiality. The Securities and Exchange Commission recommends implementation of policies and procedures to avoid violations, such as pre-clearing discussion topics with the shareholder(s) or having company counsel participate in meetings.

Recent amendments to PITER are a welcome move, however, SEBI could also consider: (1) providing further guidance on requirements for listed companies' policies on legitimate purposes – e.g., duration of confidentiality or standstill undertakings and form and manner of cleansing announcements; (2) clarifying ability of directors to share UPSI with their nominating shareholders; and (3) providing guidance and compliance standards on market sounding.

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