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Banks, financial institutions may be flouting insider trading norms

By [Sugata Ghosh](#) & [Reena Zachariah](#), ET Bureau | Updated: Feb 24, 2016, 04.34 AM IST

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MUMBAI: Many large, highstreet banks and finance houses are nonchalantly flouting [insider trading](#) rules while cutting deals to fund corporates that are listed on stock exchanges.

Capital market regulatory norms require a company to share with the public all information that it discloses to lenders and financiers — just as numbers of financial performance and ratios are divulged in M&As or placement of stocks once a deal is struck.

But, neither corporates bother nor banks insist on putting the unpublished price-sensitive information (UPSI) in public domain when a debt deal - which could be bonds, debentures or plain vanilla loans - is signed for financing business.

The regulatory concern is simple: such information shared in the course of debt finance can be misused by someone in the financial institution to trade on the shares of the listed company that is being funded. Debt [finance deals](#), for long as well as short-term funding, happen far more frequently than stock transactions like mergers and qualified institutional placement. In the process, companies reveal to banks and institutions, including multilateral funding agencies, data that are not disseminated to other shareholders and general investors who may find them useful.

Recently, some banks approached [Sebi](#) to exempt them from these insider trading regulations, said a person aware of the development. But, even as banks argued that they are required to extend debt finance as part of their normal business, the market regulator is unwilling to make any exception in case of debt deals and for banks.

"If information sought while doing due-diligence for investments in debt securities is used to trade in any other securities such as listed shares of the entity in that case it will come under insider trading," a Sebi official told ET.

In case of equity financing or inorganic deals like M&As, investment banks, lawyers and persons associated with the negotiations and entering into non-disclosure agreement, are considered as 'connected persons' - which means that if there is any accusation that a person privy to the deal has used any confidential information to trade, then the person has to defend himself to prove his innocence. Moreover, such information has to be anyway made public a little before a deal is closed.

Even if banks and other institutional investors in a debt deal are tagged as 'connected person', corporates (receiving debt finance) are reluctant to put up the information (shared for obtaining finance) on their company websites or on that of stock exchanges where their stocks are listed. On one hand, companies feel these are privileged information that should be kept away from competitors and do not have to be communicated as part of the listing agreement; on the other hand, banks - involved as syndicator or investor in a debt deal - fear losing business if they push corporates to disclose the information to the public.

"Omission of the Sodhi Committee guidance (prohibiting selective disclosure of UPSI) in the 2015 Regulations appears to suggest that UPSI may be provided to connected persons, such as bankers, selectively, as long as it is for "legitimate" purposes. However, this goes against the very essence of the 2015 Regulations that seeks to restrict the dissemination of UPSI in order to prevent insider trading," said Kaushik Mukherjee, partner, BMR Legal.

The 2015 law as well as the Sodhi panel say that "no insider shall communicate, provide, or allow access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, to any person including other insiders except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations."

The Sodhi panel, which had submitted its report in 2014, also observed that "this provision is intended to impose an obligation not to make selective disclosures of such information except within the framework for fair disclosure set out in these regulations." While this

observation is missing in the 2015 Sebi Regulations, the regulatory stance (as spelt out by the Sebi official to ET) and the "fair practice code" in the law underscore the importance and obligation to share UPSI by corporates raising money. Also, the regulations do not define "legitimate purposes" which in markets like the UK, do not include debt deals.

According to Vaneesa Abhishek, Advocate at Bombay High Court, "As long as the information about company or a class of securities (say bonds) can have bearing on the other company or other class of securities (say shares), it will be covered under insider trading regulations."

Companies till now have ignored this. But if Sebi maintains its stand, shareholders and stock market investors may soon have access to a mountain of information that companies now keep close to their chest.

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