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UPDATES

SEBI insulates deal prices from market speculation

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This update covers:

1 Background

In May 2024, SEBI revised its rules on verification of market rumours by listed companies, with an eye on offering better price protection to public M&A deals. This update discusses the key features and impact of the new framework.

The Securities and Exchange Board of India (**SEBI**) released a new '*rumour verification*' framework on 21 May 2024.[1] This follows industry criticism of SEBI's initial proposal from July 2023, which mandated large[2] listed companies to confirm or deny media reports relating to an '*impending specific material event*'.

While intended to promote information parity in the market, this requirement raised concerns about unintended consequences for public M&A deals. SEBI's takeover code uses the pre-deal stock price (in the time leading up to deal signing) to determine the price for an open offer. Similar pricing rules apply to private placements of shares in listed companies, and to share purchase transactions between an Indian resident and a non-resident. Premature deal disclosures may distort stock prices affecting price certainty for acquirors. The new framework aims to address this concern.

2 Key features of the new rumour verification framework

The new rules require the 250-largest[3] listed companies to address market rumours about an '*impending specific event*' which also causes a '*material price movement*' in the stock. A material price movement is an intra-day variation of more than 3–5% in the stock price, after adjusting for any meaningful movement in the benchmark index. The rumour must be addressed within 24 hours from the material price movement.

1 Amendment to Regulation 30 (disclosure of events or information) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 on 17 May 2024.

2 Largest 250 companies by market capitalisation.

3 The rules apply to the 100-largest listed companies with effect from 1 June 2024, and will extend to the next 150-largest companies by 1 December 2024.

If a listed company verifies a rumour about a deal to which any SEBI pricing rules apply, then the '*unaffected price*' can be used for the deal. In other words, the impact of such rumour and its confirmation on the stock price may be excluded in such cases.

Most pricing formulae under SEBI rules consider the volume weighted average price (**VWAP**) of the stock on each day over a specified look-back period (prior to deal signing). The '*unaffected price*' will be arrived at by subtracting the spike in VWAP which can be attributed to the rumour and subsequent confirmation from the daily VWAP (on each relevant day of the look-back period). For this purpose, the rise in VWAP over three trading days (the date of the rumour, the date of the confirmation, and the next trading day) will be considered as the effect of the rumour and its verification. The following illustration explains this:

Trading Day		Daily VWAP	Adjusted Daily VWAP
10-June	-	95	95
11-June	-	100	100
12-June	*Date of rumour and material price movement – VWAP frozen as previous day's VWAP*	120	100
13-June	*Date of confirmation of rumour*	125	100
14-June	*Next trading day after confirmation*	130	100
17-June	*VWAP adjusted for impact of rumour and its confirmation (Adjustment equal to VWAP on 14 June less VWAP on 11 June, i.e., 130 – 100 = 30)*	125	95
18-June		120	90
19-June		120	90
20-June		140	110
21-June	*Deal signing (start of lookback period)*	130	100

The benefit of this '*unaffected price*' is available for 60 days. This means that the deal must be signed within 60 days to qualify for this price protection. This benefit extends to 180 days if the final bidder has not been selected in a deal involving a competitive bid process.

3 Impact

The ability to use the '*unaffected price*' will protect deal prices from the influence of market speculation or rumours, a major concern in large public M&A deals. This also helps listed companies respond to market rumours confidently, knowing that any resulting volatility in the stock price will not discourage interested bidders. This will ultimately also benefit public shareholders by reducing information asymmetries and curbing speculation.

While there are concerns that the framework could force premature disclosures when deals are in early stages, the industry standards recently released by the stock exchanges provide safeguards. For instance, these clarify that no specific disclosure is necessary at early stages of a deal, such as the signing of a non-binding term sheet or commencement of due diligence.

The framework will likely lead to increased compliance costs for companies due to the need for active monitoring of media reports and tracking of stock prices – this trend, however, is to be expected as India matures as a market and there is greater regulatory emphasis on corporate governance. SEBI's initial focus on the 250-largest companies likely reflects this consideration.

The principle of '*fair market value*' in income tax laws might need to be reconciled with SEBI's new '*unaffected price*' concept since purchase of shares below fair market value has tax implications.
