

M&A Hotline

February 02, 2009

SATYAM AFTERMATH: SEBI MANDATES DISCLOSURES FOR PLEDGED SHARES

Securities and Exchange Board of India (“SEBI”) has made amendments to SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (“Takeover Code”) by issuing a notification No. LAD-NRO/GN/2008-2009/33/15022 called the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2009 (“Amended Regulations”) to provide for disclosures norms for the promoters and promoter group in case of pledge of shares held by them in the listed company.

The Amended Regulations came in the backdrop of the recent Satyam scandal where the promoters of Satyam Computers Services (“Satyam”) had announced that all the shares held by them in Satyam have been pledged with the institutional lenders and some of the institutional lenders have, or are in the process of, liquidating the pledged shares to cover the margin calls. This has brought forth the lacunae in the extant Takeover Code, SEBI (Prohibition of Insider Trading) Regulations, 1992, Listing Agreement and other regulations framed by SEBI which does not necessarily warrant a disclosure by the promoters or the promoter group when they pledge their shares in the listed company. The Amended Regulations seek to plug this loophole and impose obligations on the promoters and promoter group to disclose to the company, the details of the pledge created on the shares held by them.

KEY HIGHLIGHTS OF THE AMENDED REGULATIONS

1. *Disclosure of the pledge:* The promoter and the promoter group shall disclose to the company:

1. details of the creation of pledge of the shares; and
2. details of the invocation of pledge of shares.

The Amended Regulations also contains a transitional provision which states that the promoter and the promoter group shall disclose to the company, the details of the pledged shares held by them, as on the date of the commencement of the Amended Regulations.

2. *Disclosure time frame:* The disclosures to be made by the promoter and the promoter group to the company as mentioned under point 1 (i) and (ii) shall have to be made within 7 working days of the creation or invocation of the pledge respectively. The disclosures, as mandated under point 1(iii) shall have to be made within 7 working days of the commencement of the Amended Regulations.

3. *Disclosure by the company:* Within 7 working days of the receipt of the information from the promoter and promoter group, the company shall, in turn, make disclosure of such information to the stock exchange. The disclosures shall be made to the stock exchange if during any quarter ending on March, June, September and December of any year, the aggregate number of shares pledged by the promoter and the promoter group exceeds 25,000 or 1% of the total shareholding or voting rights of the company, whichever is lower.

Whilst it is a good step forward by SEBI with respect to increasing the disclosure requirements for the promoter and the promoter group in event of pledge of shares in light of the recent Satyam scandal, some of the following aspects could have been looked into by SEBI to give more teeth to the Amended Regulations:

1. *Indirect holding by the promoters:* The Amended Regulations mandates disclosures in the event of promoters and promoter group pledging their shares in the listed company. However, there exists a loophole with respect to indirect pledge of shares of the company by the promoter and the promoter group as the same is not expressly captured by the Amended Regulations. It is to be kept in mind that SEBI has to carefully tread the path to provide a meaningful disclosure coverage as it is very common under the Indian corporate scenario where the promoters hold the shares of the listed entity through a holding company.

1. *Limited applicability:* The Amended Regulations mandates disclosure requirements only on the promoters and the promoter group. However, the mandate of the disclosure requirements in the event of pledge of shares should ideally also be extended to the directors, senior employees and significant shareholders of the company. We understand that under the US laws, the directors are mandated to disclose the shares held by them which are pledged as security.

1. *Negative pledge:* The Amended Regulations mandates disclosures of the details of the pledge at the time of creation and invocation. It would be interesting to see whether such disclosures at the time of creation and invocation of pledge would cover a situation of negative pledge. A “negative pledge” is a covenant granted by

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the borrower to the lender in which an undertaking is made by the borrower not to convey the shares to a third party or to otherwise create an encumbrance. It would be interesting to see whether the Amended Regulations would cover the situation of negative pledge in line with the best practices followed in the USA.

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1. *Disclosure time frame:* The Amended Regulations provide for a time frame of 14 working days from the date of creation/ invocation of charge till the information has been provided to the stock exchange by the company. Although the time frame for the disclosures as provided under the Amended Regulations is more than the time frame mandated for other disclosures under the Takeover Code, SEBI might have given a more relaxed time frame keeping in mind the practical and commercial dynamics involved in the case of invocation of pledge. It would be worthwhile to observe whether SEBI would reduce the time frame for disclosures for pledge of shares in line with the other disclosures over a period of time.

CONCLUSION

While Satyam saga has already challenged the existing laws, SEBI has learnt from the experiences and acted in a timely manner to cover the loophole on disclosures of pledge of shares. SEBI's move to increase the disclosure coverage, in the light of the Satyam saga and in line with the international best practices, is truly commendable.

- Abir Roy & Nishchal Joshipura

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