Pledging to do more

The amendment mandates that the promoters and/or promoter group should disclose to the company the details of share pledges within seven working days of the pledge

Abir Roy and Nishchal Joshipura

As a response to the Satyam scandal, the Securities and Exchange Board of India (Sebi) made certain amendments to its rules and guidelines in January. It provided for disclosure norms when promoters of a listed company pledge their shares. However, there are certain aspects that could have been considered by Sebi to give more teeth to the amendments.

Let us review the changes made. The amendment mandates that the promoters and/or promoter group should disclose to the company the details of share pledges within seven working days of the pledge.

The company should, in turn, disclose such information to the stock exchange within another seven days. The disclosures shall be made to the stock exchange during any quarter if the aggregate number of shares pledged by the promoter exceeds 25,000 shares or 1% of the company, whichever is lower.

While the step taken by Sebi in the wake of the Satyam saga is commendable, the following aspects could have been considered to provide a more meaningful disclosure coverage:

First, the amendments do not mandate disclosures in the event of indirect pledging of shares of the listed company by the promoter. In the Indian corporate scenario, it is very common for promoters to hold their shares of the listed entity through a holding company owned by them. Thus, the disclosure coverage should have covered situations when the promoters pledge the shares of the holding company.

Second, these mandated disclosures for share pledges are only applicable to the promoter. However, such disclosure requirements for share pledges should ideally also be extended to others. When promoters pledge shares to banks in exchange for loans, they may default on the loan if the share price drops; in that event, the bank can seize the shares and even sell them, which, in turn, can have an adverse downward impact on the share price.

In line with the best practices followed globally, the disclosure coverage should also encompass pledging of shares, whether direct or indirect, by a significant shareholder, director or senior employee. This is to offer the same protections to the minority shareholders that disclosures on part of the promoters provide.

Third, it would also be interesting to see whether the pledge disclosures would cover a situation of negative pledging. Negative pledge refers to an undertaking provided by the promoter for not conveying the shares to a third party, or to otherwise create some restriction on share movement. Sebi may not have intended to cover this under its disclosure norms simply because negative pledges do not affect promoter holdings. Yet, negative pledges should be covered to allow shareholders to learn about the restrictions on their shares.

Fourth, the amendments provide for a time frame of 14 working days from the date of creation or invocation of pledge to providing information to the stock exchange. This 14-day period is longer than the time frame mandated for other disclosures under the takeover code. Given that investors make timely decisions based on such information, Sebi would serve shareholders well to reduce the time lag of 14 working days in the future to bring it in line with other disclosure timelines.

Sebi has played a commendable role in amending the securities law to respond to the ever changing market conditions. A move to strengthen these mandatory disclosures for share pledges will not only ensure higher standards of transparency but will also align our securities law with best global practices.

Abir Roy and Nishchal Joshipura are Mumbai-based corporate lawyers at Nishith Desai Associates. Comment at otherviews@livemint.com

Abir Roy and Nishchal Joshipura