

## **Disclosure of Encumbrances**

### **1. Objective**

1.1. This memorandum seeks approval of the Board to amend SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“Takeover Regulations”) in relation to disclosure of encumbrances by promoters of listed companies.

### **2. Background**

2.1. The requirement to disclose the details regarding pledging of shares by promoters were introduced in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 through amendment w.e.f. January 28, 2009. Subsequently, the requirement continued in the Takeover Regulations notified in 2011 and was further expanded to cover all types of encumbrances.

2.2. Recently concerns have been raised with regard to exposure of mutual funds to debt and money market instruments through structured obligations, pledge of shares, non disposal undertakings (NDUs), related party transactions, corporate/ promoter guarantees and various other complex structures.

2.3. A report published by CRISIL on March 25, 2019 titled “Covering the pledge” provides an indication of the size of the market for loan against shares. It is noted from the said report that the total value of shares pledged by promoters, according to BSE data, is more than Rs 2 lakh crore, involving 800 companies<sup>1</sup>. This CRISIL report is only in respect of loan against shares pledged (in the depository system) and does not include other encumbrances such as NDUs.

2.4. As per the CRISIL report, this has implications for the lending community, for such debt is backed by collateral of equity shares, which are inherently volatile, rather than by cash flows. CRISIL also states that pledged debt is exposed to

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<sup>1</sup>As on February 27, 2019

high levels of equity risk, and the cover through pledged shares is usually small to absorb these risks.

2.5. In view of the above, SEBI has reviewed the regulatory requirements in respect of disclosures of encumbrances (including pledge).

### **3. Definition of Encumbrance**

3.1. For the purpose of disclosure requirements, it has been mentioned under Regulation 28(3) of Takeover Regulations that the term 'encumbrance' includes a pledge, lien or any such transaction, by whatever name called.

3.2. Further, SEBI by way of FAQ has clarified the following:

- i. The promoters have to understand the nature of encumbrance and that those encumbrances which entail a risk of the shares held by promoters being appropriated or sold by a third party, directly or indirectly, are required to be disclosed to the stock exchanges in terms of the Takeover Regulations.
- ii. All types of NDUs by promoters will be covered under the scope of disclosures of 'encumbrances' under the Takeover Regulations.

3.3. Recently, some instances have come to light where private limited companies (controlled by the promoter(s) of a listed company) issue NCDs backed by the promoter(s) either in the form of pledge of securities (including shares) of a group company or through other forms of encumbrances such as covenants, NDUs, etc. which are very complex in nature. The intention of the Takeover Regulations is to cover all types of encumbrances by whatever name called. Accordingly, it is felt that there is a need to further clarify the scope of encumbrance and make it more specific for the purpose of disclosure requirements.

## **Primary Markets Advisory Committee (PMAC)**

3.4. The issue was discussed in the meeting of PMAC held on May 16, 2019. PMAC inter alia recommended the following:

- i. The scope of encumbrance may be further clarified in the Takeover Regulations. The proposed definition of “encumbrance” may be on the below lines:

“encumbrance” shall mean any fetter on the free and marketable title to the shares whether by way of pledge, lien, negative lien, non disposal undertaking or any other covenant, transaction, condition or arrangement, by whatever name called, executed directly or indirectly.”

## **Proposal**

3.5. The scope of ‘encumbrance’ may be further clarified in the Takeover Regulations. In order to retain the inclusive nature of the definition of encumbrance, the definition of encumbrance may be considered as follows:

‘the term “encumbrance” shall include, -

- i. any restriction on the free and marketable title to shares, by whatever name called, whether executed directly or indirectly;
- ii. pledge, lien, negative lien, non-disposal undertaking;
- iii. any covenant, transaction, condition or arrangement in the nature of encumbrance, by whatever name called, whether executed directly or indirectly.’

3.6. The consequential changes in the FAQs may also be carried out.

## **4. Disclosure of pledge by promoters and target company<sup>2</sup>**

4.1. Regulation 31(1) of the Takeover Regulations provides that the promoter of every target company shall disclose details of shares in such target company

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<sup>2</sup>For the purpose of Takeover Regulations, promoters include promoter group entities

encumbered by him or by persons acting in concert (PAC) with him in the format specified by SEBI.

- 4.2. Further, Regulation 31(2) of the Takeover Regulations provides that the promoter of every target company shall disclose details of any invocation of such encumbrance or release of such encumbrance of shares.
- 4.3. The above disclosures are required to be made within 7 working days from the creation or invocation or release of encumbrance to the stock exchanges and the target company.
- 4.4. The formats for disclosures under Regulation 31(1) and (2) have been provided by SEBI. Presently, the format inter alia provides for the following disclosures by promoters (including for the entire promoter group):
  - a) Promoter holding already encumbered - No. of shares and % of total share capital (as per latest filing)
  - b) Details of encumbrance including name of the entity in whose favor shares encumbered
  - c) Post event holding of encumbered shares - No. of shares and % of total share capital (as per latest filing)
- 4.5. All stakeholders, including minority shareholders should be aware of the detailed reasons for pledging of shares by the promoters, particularly for situations where promoters are holding a significant stake and have pledged their shares. In case of defaults, the shares of promoters can be invoked and sold by the lenders in large quantities which may lead to distress sale and fall in prices, affecting other investors, including minority shareholders.

#### **PMAC**

- 4.6. PMAC at its meeting held on May 16, 2019 inter alia recommended the following:

- a) The purpose of encumbrance shall be disclosed by the promoters if the combined encumbrance by the promoters and PACs crosses 20% of the total share capital in the company; and
- b) The stock exchanges will maintain the details of listed companies having encumbrance of promoters and PACs of 20% or more of the total share capital, along with purpose of encumbrance, on their websites.

### **Proposal**

4.7. It is noted that SEBI has by way of circular dated August 05, 2015 revised the format for disclosures under Regulation 31 of Takeover Regulations wherein a column on 'Reasons for encumbrance' was inserted in the format. There are 14 columns in the format and the reasons for encumbrance is one of them. In order to draw greater attention of the investors towards reasons for encumbrances (in cases of significant encumbrances by promoters), it is proposed that SEBI may prescribe the following requirements additionally, by way of circular:

- a) Require promoters to disclose separately detailed reasons for encumbrance whenever the combined encumbrance by the promoters and PACs crosses 20% of the total share capital in the company.
- b) Further, to cover existing cases, it is proposed that a one-time separate disclosure regarding detailed reasons of encumbrance shall be made by the promoters for such companies, where the encumbrance by promoters and PACs is 20% or more of the total share capital.
- c) The stock exchanges will maintain the details of listed companies having encumbrance of promoters and PACs of 20% or more of the total share capital, along with purpose of encumbrance, on their websites.

## **5. Monitoring of disclosures**

5.1. With respect to pledging of shares through the depositories, the information regarding pledging of shares is disseminated by the stock exchanges (NSE and

BSE) through system driven disclosures introduced by SEBI from January 02, 2016 onwards.

- 5.2. The system driven disclosures mentioned above are only with respect to entities flagged as promoters in the database of depositories and do not include PACs. In respect of other types of encumbrances (e.g. liens, NDUs etc.) created on the shares of the listed companies, it is difficult to monitor whether the regulatory requirements are being complied with.

### **PMAC**

- 5.3. PMAC at its meeting held on May 16, 2019 inter alia recommended the following:

- a) The promoters shall declare on a yearly basis, that they along with PACs, have not made any encumbrance directly or indirectly, other than already disclosed, during the financial year. The said declaration may be made by the promoters to the audit committee of the target company and to the stock exchanges.

### **Proposal**

- 5.4. The Takeover Regulations may be amended to give effect to the proposal at 5.3(a) above.

## **6. Proposals**

- 6.1. The draft amendments in the Takeover Regulations have been brought out at **Annexure - I**.
- 6.2. The Board is requested to consider and approve the proposals under paragraphs 3.5, 3.6, 4.7, 5.4 and the draft amendments in Takeover Regulations at Annexure-I and authorize the Chairman to take consequential and incidental steps to give effect to the decisions of the Board.

**(The Board Memorandum must be read in conjunction with the press release issued on June 27, 2019 and minutes of the meeting)**

**THE GAZETTE OF INDIA  
EXTRAORDINARY  
PART – III – SECTION 4  
PUBLISHED BY AUTHORITY  
NEW DELHI, [●], 2019  
SECURITIES AND EXCHANGE BOARD OF INDIA  
NOTIFICATION  
Mumbai, the [●], 2019**

**SECURITIES AND EXCHANGE BOARD OF INDIA (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) (SECOND AMENDMENT) REGULATIONS, 2019**

No. [●]. — In exercise of the powers conferred under section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board hereby makes the following Regulations to further amend the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, namely:

1. These regulations may be called the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2019.
2. They shall come into force on the date of their publication in the Official Gazette.
3. In the Securities and Exchange Board of (Substantial Acquisition of Shares and Takeovers) Regulations, 2011:
  - I. in regulation 28, sub-regulation (3) shall be replaced with the following,
    - (3) For the purposes of this Chapter, the term “encumbrance” shall include,-
      - (a) any restriction on the free and marketable title to shares, by whatever name called, whether executed directly or indirectly;
      - (b) pledge, lien, negative lien, non-disposal undertaking;

(c) any covenant, transaction, condition or arrangement in the nature of encumbrance, by whatever name called, whether executed directly or indirectly.

II. in regulation 31, the following new sub-regulations (4) and (5) shall be inserted:

(4) The promoter of every target company shall declare on a yearly basis that they, along with persons acting in concert, have not made any encumbrance, directly or indirectly, other than already disclosed during the financial year.

(5) The declaration required under sub-regulation (4) shall be made within seven working days from the end of each financial year to –

(a) every stock exchange where the shares of the target company are listed; and

(b) the audit committee of the target company.

**AJAY TYAGI**  
**CHAIRMAN**  
**SECURITIES AND EXCHANGE BOARD OF INDIA**

**Footnotes:**

1. The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 were published in the Gazette of India on 23rd September, 2011 vide No. LAD-NRO/GN/2011 12/24/30181.
2. The Principal Regulations were subsequently amended on:
  - (a) March 26, 2013 by the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2013 vide No. LAD-NRO/GN/2012 13/36/7368.



- (b) October 8, 2013 by the SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013 vide No. LAD-NRO/GN/2013-14/28/6720.
- (c) May 23, 2014 by the SEBI (Payment of Fees) (Amendment) Regulations, 2014 vide Notification No. LAD-NRO/GN/2014-15/03/1089.
- (d) March 24, 2015 by the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2015 vide No. LAD-NRO/GN/2014-15/28/542.
- (e) May 5, 2015 by the SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2015 vide No. SEBI/LAD-NRO/OIAE/GN/2015-16/004.
- (f) August 14, 2015 by the SEBI (Substantial Acquisition of Shares and Takeovers) (Third Amendment) Regulations, 2015 vide No. SEBI/LAD-NRO/GN/2015-16/009.
- (g) December 22, 2015 by the SEBI (Substantial Acquisition of Shares and Takeovers) (Fourth Amendment) Regulations, 2015 vide No. SEBI/LAD-NRO/GN/2015-16/026.
- (h) February 17, 2016 by the SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2016 vide No. SEBI/LAD-NRO/GN/2015-16/035.
- (i) May 25, 2016 by the SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2016 vide No. SEBI/ LAD-NRO/GN/2016-17/002.
- (j) March 6, 2017 by SEBI (Payment of Fees and Mode of Payment) (Amendment) Regulations, 2017 vide No. SEBI/LAD/NRO/GN/2016-17/037

read with notification dated March 29, 2017 vide No. SEBI/LAD/NRO/GN/2016-17/38.

- (k) August 14, 2017 by SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2017 No. SEBI/LAD-NRO/GN/2017-18/015.
- (l) June 01, 2018 by SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2018 No. SEBI/LAD-NRO/GN/2018/20.
- (m) September 11, 2018 by SEBI (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2018 No. SEBI/LAD-NRO/GN/2018/33.
- (n) December 31, 2018 by SEBI (Substantial Acquisition of Shares and Takeovers) (Third Amendment) Regulations, 2018 No. SEBI/LAD-NRO /GN/ 2018/55.
- (o) March 29, 2019 by SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2019 No. SEBI/LAD-NRO /GN/ 2019/06.

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