

M&A Hotline

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SHARE PLEDGE TRUSTEES NOT ON SAME FOOTING AS BANKS AND PFI'S: SEBI

The Securities and Exchange Board of India ("SEBI") has issued two separate but similar informal guidance to IL&FS Trust Company Limited ("ITCL") and IDBI Trusteeship Services Limited ("ITSL") on April 12, 2012 and April 26, 2012, respectively under the SEBI (Informal Guidance) Scheme 2003 (collectively the "Guidance"). In this Guidance, SEBI has expressed its views on the obligations under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997, (the "Old Takeover Code") and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the "New Takeover Code") of a trustee that holds shares as a pledgee for and on behalf of scheduled commercial banks and public financial institutions (the "Share Pledge Trustee").

Though clarification was also sought on whether, (i) locked-in securities of a promoter can be pledged in favor of the Share Pledge Trustee under Regulation 39 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and (ii) the term encumbrance under the New Takeover Code would include negative lien, non-disposal undertaking and shares given on power of attorney, SEBI did not provide its views on these questions.

FACTUAL BACKGROUND

ITCL and ITSL are intermediaries registered with SEBI for rendering debenture trusteeship services. They provide a wide range of fiduciary trusteeship services to banks, public financial institutions ("PFIs"), corporate and non-corporate entities for consideration in the form of fees. While discharging their duties as a trustee acting on behalf of banks and PFIs, instances have arisen where the scrips of listed companies offered as collateral for the loans granted by such banks and PFIs need to be pledged in their favor as a trustee. In such cases, ITCL or ITSL shall be acting as pledgee for such listed securities solely in its professional capacity as a trustee and the banks and PFIs hold the economic interests in such collateral shares.

QUERIES

Since the Old Takeover Code¹ and the New Takeover Code² specifically exempt banks and PFIs from disclosure obligation on pledge of shares in their favor and open offer obligation on invoking such pledge, will the Share Pledge Trustee acting on behalf of such banks and PFIs be also exempt from such obligations and will the result be any different if the Share Pledge Trustee is acting on behalf of financial institutions that are not eligible for the exemptions under the New Takeover Code?

SEBI'S RESPONSE

SEBI has concluded that there are no express provisions either in the Old Takeover Code or in the New Takeover Code that exempt "debenture trustees" acting as custodian/ agent for pledged shares on behalf of the lenders from the obligations under such regulations. SEBI has opined in this Guidance that the exemption granted to banks and PFIs under the Old Takeover Code and the New Takeover Code cannot be extended to the Share Pledge Trustee even if the Share Pledge Trustee was acting on behalf of such exempted banks and PFIs.

ANALYSIS

■ Aggregation of shareholding

SEBI has opined that the Share Pledge Trustee is bound by the disclosure obligation under the Takeover Code on pledge of shares in its favor even when the pledge is on behalf of banks and PFIs. Further, the Share Pledge Trustee shall also be required to make an open offer if its voting rights in the target company exceed the prescribed thresholds on invocation of such pledge, says SEBI. SEBI seems to have disregarded the beneficial interest that the banks and PFIs have on the pledged shares to obligate the Share Pledge Trustee to undertake the abovementioned obligations under the Takeover Code. In effect, SEBI appears to treat the trustees such as the Share Pledge Trustee to be the "acquirer" under Regulation 2(1)(a) of the Takeover Code. If so, it is pertinent to determine whether the shares held by such trustees in the target company or pledged in their favor in different and independent capacities would be aggregated/ clubbed for the purpose of determining the obligations of the trustees under the Takeover Code.

■ Illustration

The initial threshold for disclosure obligation under the New Takeover Code is acquisition of 5% of the shares of the target company. If (i) 2% of the shares of the target company, currently owned by 'A' is pledged in favor of the Share Pledge Trustee on behalf of 'Bank 1', and (ii) 2% of the shares of the target company, currently held by 'B' is pledged in favor of the Share Pledge Trustee on behalf of 'Bank 2', and (iii) 3% of the shares of the target company are currently held in the name of the Share Pledge Trustee, as a trustee acting on behalf of 'C', will the aggregate

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shareholding of the Share Pledge Trustee in the target company shall be considered as 7% for determining the disclosure obligation?

This question can be more alarming for the Share Pledge Trustee when made in the context of open offer obligation.

■ **Spirit of the Takeover Code**

Under the New Takeover Code, scheduled commercial banks or PFIs acting as pledgee in the ordinary course of business are exempt from open offer⁴ and disclosure³ obligations to facilitate their business operations. It will be quite tiresome for banks and PFIs should they be required to disclose each time a pledge is created in their favor as collateral or if they have to make an open offer on each invocation of pledge in excess of the prescribed thresholds. Since the creation and invocation of a pledge by banks and PFIs are not done with an intention to acquire a substantial stake or control in the target company but to protect the economic interest of the banks and PFIs by securing repayment of loans, the spirit of the Takeover Code is not compromised. Further, transparency requirements under the Takeover Code are also met as the promoters are in any event bound to disclose creation of pledge on their shares.⁵

Accordingly, when banks and PFIs are exempt from the obligations under the Takeover Code it may not be appropriate to impose the very same obligations on the Share Pledge Trustee that is acting on their behalf. The Share Pledge Trustee is solely rendering professional services to banks and PFIs to fulfill their business objectives. Therefore, the benefits that are accorded to banks and PFIs could also be extended to the Share Pledge Trustee acting on their behalf. However, it may not be possible for SEBI to interpret the existing provisions of the New Takeover Code under the informal guidance route to achieve this and a specific amendment to the New Takeover Code to this effect may be required.

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You can direct your queries or comments to the authors

¹Explanation to Regulation 7(1) and (1A) of the Old Takeover Code

²Regulation 29(4) of the New Takeover Code

³Regulation 10(1)(b)(viii) of the New Takeover Code

⁴Regulation 29(4) of the New Takeover Code

⁵Regulation 31(1) of the New Takeover Code

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