SEBI REGULATIONS ON PLEDGED SHARES AND INVESTOR PROTECTION

Prachi Tiwari, B.A. LL.B. (Hons.), Narsee Monjee Institute of Management Studies, School of Law, Navi Mumbai

ABSTRACT

Promoters of listed companies frequently raise financing by pledging their shares as collateral with banks and other lenders. While this is a legitimate financing tool, it carries significant risk for minority shareholders: if a promoter defaults, the lender can invoke the pledge and sell the shares in the open market, triggering price volatility, loss of promoter control, and losses for public investors. This article examines how the Securities and Exchange Board of India (SEBI) addresses this risk through a disclosure-based, rather than prohibition-based, regulatory framework. It analyses the disclosure obligations under Regulation 31 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, along with the promoter contribution and lock-in requirements under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018. It also covers SEBI's enhanced disclosure threshold for high levels of promoter encumbrance, and its separate Margin Pledge and Re-pledge framework, introduced after the 2019 Karvy Stock Broking case, which protects retail investors whose own securities are pledged with brokers as trading margin. The article then discusses the practical conflict that historically arose between pledge and lock-in restrictions on the same shares, and how SEBI's 2026 ICDR amendment resolved this by permitting depositories to mark pledged shares as "non-transferable" during the lock-in period. The article concludes that SEBI's evolving framework reflects a consistent commitment to investor protection through transparency rather than restriction.

Introduction

The Indian securities market has long grappled with the risks that promoter share pledging poses to minority shareholders and market stability. Promoters often pledge their shareholding to raise loans for business or personal purposes, and this practice is not, in itself, prohibited by law. However, when a pledge is invoked following a default, the resulting sale of shares in the open market can significantly depress share prices, dilute promoter control, and leave minority shareholders exposed to losses they had no part in causing and often no advance warning of recognising this risk, SEBI has built a regulatory architecture around pledged shares that is fundamentally disclosure-oriented. Rather than banning or capping the practice, SEBI requires promoters and listed companies to disclose the existence, creation, invocation, and release of pledges, along with periodic reporting of shareholding patterns. This regulatory philosophy runs across three key sets of regulations the SAST Regulations, 2011, the LODR Regulations, 2015, and the ICDR Regulations, 2018 each of which addresses a different stage or dimension of the risk. Most recently, SEBI's 2026 amendment to the ICDR Regulations resolved a long-standing practical conflict between pledge arrangements and IPO lock-in requirements, further strengthening this framework.

This article examines each of these regulatory layers in turn including the enhanced disclosure threshold for high promoter encumbrance and SEBI's parallel margin pledge framework protecting retail investor securities held with brokers before analysing the 2026 ICDR amendment and its implications for issuers, promoters, and investors.

What a Pledged Share means?

When a promoter of a listed company borrows money from a bank or any other lender against the shares they hold, those shares are said to be "pledged." The shares act as collateral: if the promoter repays the loan, the pledge is released; if the promoter defaults, the lender is entitled to invoke the pledge and sell the shares in the open market to recover its dues.

This arrangement, while a legitimate financing tool, carries real risks for the company and its shareholders.

Why Pledged Shares Are a Cause for Concern

Consider a simple scenario:

- A promoter owns 50% of a company.
- Of this, 40% is pledged against a loan.
- The promoter subsequently defaults.

The lender can now invoke the pledge and dump the shares on the market to recover its money. The fallout typically includes:

1. A sharp fall in share price, triggered by the sudden, large-scale sale of shares.
2. Loss of promoter control, since a significant chunk of their holding changes hands.
3. Losses for minority shareholders, who are left holding shares in a company whose ownership and price stability, have been disrupted often with no advance warning.

SEBI's Approach: Disclosure, Not Prohibition

SEBI does not prohibit promoters from pledging their shares. Instead, it regulates the practice through disclosure requirements, thresholds, and conditions designed to keep investors informed about:

- How many shares are pledged;
- When a pledge is created;
- When a pledge is released; and
- When a lender invokes the pledge.

This disclosure-first philosophy runs through three key sets of regulations: the SAST Regulations, 2011, the LODR Regulations, 2015, and the ICDR Regulations, 2018.

Under Regulation 28(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011[1], "encumbrance" is defined broadly to include a pledge, a lien, a non-

[1] SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Reg.28

disposal undertaking, or any other arrangement that restricts the transferability of shares or creates a security interest over them.

Regulation 31 of the SAST Regulation, 2011[2] governs disclosure of encumbered shares.

- Regulation 31(1) requires promoters to disclose details of shares pledged by themselves or by persons acting in concert (PACs).
- Regulation 31(2) requires disclosure of the creation, invocation, and release of any pledge.
- Regulation 31(3) sets a 7-working-day window for this disclosure to be made to the listed company and to all stock exchanges where it is listed.
- Regulation 31(4) requires promoters to certify annually that they have not created any undisclosed encumbrance.

Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015[3] adds a further layer of investor protection by mandating periodic disclosure of a listed entity's shareholding pattern:

- Regulation 31(1) requires a listed entity to submit a quarterly statement to stock exchanges showing its shareholding pattern, including promoter and promoter group holdings and any shares encumbered or pledged by them. This allows investors to track the extent of promoter control and leverage over time.
- Regulation 31(2) requires 100% of promoter and promoter group shareholding to be held in dematerialized form, making it easier to monitor and verify.
- Regulation 31(4) requires separate disclosure for each promoter and promoter group entity, published on stock exchange websites.

Together, these provisions reduce information asymmetry and give investors the data they need to make informed decisions about promoter-backed risk.

---

[2] SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Reg.31
[3] SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, Reg.31

SEBI has, over time, tightened these disclosure norms further. Under a reform requiring more detailed reporting, listed companies must furnish detailed reasons for any encumbrance on promoter shareholding once the combined encumbrance crosses half of the promoter's holding in the company. This threshold-based rule ensures that once promoter pledging reaches a level that could meaningfully threaten company control or market stability, investors are given not just the fact of the pledge but the rationale behind it sharpening the disclosure regime beyond a simple record of transactions.

While the SAST and LODR frameworks focus on disclosure for already-listed companies, the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 protect investors at the point of a public offering, through rules on promoter contribution, lock-in, and disclosure of encumbered shares.

The underlying goal is to ensure promoters retain a meaningful stake in the company after listing aligning their interests with public investors and discouraging opportunistic exits right after an IPO.

- **Regulation 14**[4] requires promoters to contribute at least 20% of the post-issue capital as minimum promoter contribution, ensuring they bear a genuine share of the business risk alongside public shareholders.

- **Regulation 16**[5] locks in this minimum promoter contribution for a specified period, preventing promoters from exiting immediately after listing. This serves three investor-protection goals: it prevents short-term profiteering, ensures post-listing shareholding stability, and builds investor confidence in the issuer.

- **Regulation 17**[6] extends lock-in requirements to promoter holdings beyond the minimum contribution; ensuring promoters retain a substantial stake through the critical post-listing phase.

Before 2026, pledged shares created a practical problem for IPO-bound companies. Depositories struggled to simultaneously record both a pledge and a lock-in on the same shares. As a result, promoters were often forced to release existing pledges before proceeding with an

[4] SEBI Issue of Capital and Disclosure Requirements) Regulations, 2018 Reg.14
[5] SEBI Issue of Capital and Disclosure Requirements) Regulations, 2018 Reg.16
[6] SEBI Issue of Capital and Disclosure Requirements) Regulations, 2018 Reg.17

IPO causing financing complications, delaying public offerings, and ultimately affecting all shareholders, particularly minority shareholders.

To address this, SEBI through a notification amended the ICDR Regulations in 2026[7], the amendment in Regulation 17 of the ICDR Regulations allowed depositories to mark pledged shares as "non-transferable" for the duration of the lock-in period, instead of requiring the pledge to be released. In effect, where a lock-in cannot otherwise be created on securities that are already pledged, the depository can now record those securities as non-transferable for as long as the lock-in applies.

This reform let the pledged shares remain encumbered and subject to lock-in at the same time, removing the need to unwind financing arrangements before listing.

Importantly, even if a lender invokes the pledge during the lock-in period, the shares remain non-transferable until the lock-in expires. Ownership may pass to the lender on invocation, but the lender cannot immediately sell the shares in the market. This preserves the purpose of the lock-in and prevents promoters from indirectly bypassing regulatory restrictions through pledge arrangements.

To operationalize this, companies must amend their Articles of Association to authorise instructing depositories to impose non-transferability on pledged shares. Offer documents such as the Draft Red Herring Prospectus (DRHP) and Red Herring Prospectus (RHP) must also carry detailed disclosures on pledged shares, lock-in restrictions, and the risks involved.

Beyond Promoters: The Margin Pledge Framework for Retail Investor Securities

While the SAST, LODR, and ICDR frameworks address promoter-level pledging, SEBI has separately built a regulatory regime to protect retail investors whose own securities are pledged with stock brokers as trading margin a risk category that came into sharp focus after the 2019 Karvy Stock Broking case[8], in which client securities were pledged by the broker without proper authorisation to raise unauthorised loans.

---

[7] Securities and Exchange Board Of India (Issue Of Capital and Disclosure Requirements) (Amendment) Regulations, 2026, No. SEBI/LAD-NRO/GN/2026/299, Issued Notification on 16th March,2026

[8] Karvy Demat Case: How has SEBI Responded? – IndiaCorpLaw, (June 20, 2023), https://indiacorplaw.in/2023/06/20/karvy-demat-case-how-has-sebi-responded/.

In response, SEBI introduced the Margin Pledge and Re-pledge (MPR) system in 2020[9], ending the earlier practice under which brokers used a client's Power of Attorney to move securities out of the client's demat account and into their own pool account. Under the MPR system, a client's securities never leave their own demat account; instead, a lien is marked in the depository's records in favour of the broker, who may then re-pledge the securities with the clearing corporation to obtain margin. This keeps ownership, visibility, and control with the investor at every stage.

SEBI strengthened this framework further through a 2025 circular[10], which introduced daily ISIN-level reporting of pledged securities, real-time alerts to investors whenever a pledge, un-pledge, or re-pledge occurs, and a same-day (T+0) release of securities once a pledge is discharged. The circular also streamlined the invocation process: a single "pledge release for early pay-in" instruction now replaces what was previously a two-step process, reducing the chances of client securities being left stranded or misused in a broker's account after invocation.

Together, these reforms extend SEBI's disclosure-and-transparency philosophy from the promoter level down to the individual retail investor, closing a gap that had previously allowed brokers discretion over client collateral with limited real-time oversight.

Conclusion

SEBI's regulatory philosophy on pledged shares is not one of restriction but of transparency. Through the SAST Regulations, LODR Regulations, and ICDR Regulations, SEBI ensures that promoter pledging a legitimate financing tool does not come at the cost of investor awareness or market stability. The 2026 ICDR amendment marks a practical evolution of this framework, reconciling the once-conflicting requirements of pledge and lock-in, and closing a gap that had created friction for both issuers and investors in the IPO process.

---

[9] *SEBI | Margin Obligations to Be given by Way of Pledge/ Re-Pledge in the Depository System*, https://www.sebi.gov.in/legal/circulars/feb-2020/margin-obligations-to-be-given-by-way-of-pledge-re-pledge-in-the-depository-system_46082.html.

[10] *SEBI | Margin Obligations to Be given by Way of Pledge/Re-Pledge in the Depository System*, https://www.sebi.gov.in/legal/circulars/jun-2025/margin-obligations-to-be-given-by-way-of-pledge-re-pledge-in-the-depository-system_94363.html.