Advances against shares and debentures

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September 19, 2000

The Chairman & Managing Director,
All-India Term Lending and Refinance Institutions.

Dear Sir,

Advances against shares and debentures

It has been brought to our notice that a financial institution has granted advances against shares that were already pledged with some other financial institution for obtaining loans against them. Such type of fraud could have been avoided if the transfer procedure or registration of lien in respect of shares held as security had been adopted by financial institutions, irrespective of the fact whether shares were obtained as primary or collateral security against such advances. In order to avoid such a situation, it is advised as under :

2. Whenever the limits of advances granted to a borrower against the security of shares/debentures exceed Rs.10 lakhs, it should be ensured that the said shares/debentures are transferred in the FI's name.

3. The Securities Exchange Board of India (SEBI) has amended the SEBI (Depositories & Participants) Regulations, 1996 to facilitate the pledge of dematerialised securities. The securities pledged by the borrower get blocked in favour of the lending FI. In the case of default by the borrower, the FI may invoke the pledge, subject to the provisions of the pledge document and on such invocation, the depository will register the name of the FI as beneficial owner of such securities. In view of the above position, securities which are held in dematerialised form under the depository system, the requirement that the shares/debentures should be transferred in FI’s name need not be insisted upon provided the securities have been blocked in favour of lending FI. FIs are therefore free to take their own decision in regard to transfer of securities in their name.

4. In view of the facility provided by the depository system under the Depositories Act, 1996 to hold shares/debentures in dematerialised form, FIs could accept

shares/debentures held in such form in addition to those in the physical form as security for advances to further safeguard their interests.

5. Please acknowledge receipt.

Yours faithfully,

(K. C. Bandyopadhyay)
Chief General Manager