



## CONSULTATIVE PAPER WITH RESPECT TO GUARANTEES PROVIDED BY A LISTED COMPANY

### Background and rationale for review

1. Instances have come to the notice of SEBI where listed companies have extended corporate guarantees on behalf of their promoters/promoter related entities. It is also observed that, at times, promoter/promoter related entities have sourced funds through various complex structures and structured obligations, for which the listed companies have provided guarantees, detrimental to the interest of their shareholders. This consultation paper is aimed at reviewing the practice of listed companies extending corporate guarantees/ security for the benefit of promoter/promoter related entities, where the listed companies do not derive any economic benefit.

### Current regulatory provisions pertaining to guarantees by listed companies

1. Section 185 of the Companies Act 2013 restricts the companies to extend any loan or provide any guarantees/ securities in connection with a loan to any of its directors or his/her related entities, subject to exemptions mentioned therein. Loans or guarantees/ securities in connection with any loan can be extended to the directors/ related entities provided a special resolution is passed by the company and such loans are utilized by the borrowing entity for the principal business activity. An explanatory statement along with such notice shall also contain details of such loans, guarantees or securities including the purpose for which they would be utilized.
2. Section 186 of the Companies Act 2013 states that no company shall directly or indirectly provide any loan or any guarantee/ security in connection with a loan to any body-corporate or person or subscribe/ purchase securities of other body corporate exceeding sixty per cent of its paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves and securities premium account, whichever is more. The company can exceed the said limits provided a special resolution to that effect is passed in the general meeting.
3. Regulation 30 read with Part B of Schedule III of SEBI (LODR) Regulations, 2015 requires the listed entity to disclose guarantees or indemnities or surety on becoming a third party, subject to the application of the materiality guidelines. Furthermore, SEBI vide circular no. CIR/CFD/CMD/4/2015 dated September 09, 2015 read with Regulation 30 requires the details of guarantees/ indemnities etc. and whether such guarantees are extended to promoter/ promoter related entities along with the impact of such guarantees/ indemnities etc.



Analysis & Rationale

1. While provisions require passing of special resolution for providing any loan or any guarantee / security in connection with a loan above certain limit, there is no prohibition on issuance of such loan or any guarantee / security in connection with a loan by companies, to any person or body corporate, including a promoter wherein listed company has no economic interest. Such loan or any guarantee / security in connection with a loan by a listed company create obligation on the listed company without any benefit or return. Such practices are not in the interests of shareholders of listed company, particularly minority shareholders.
2. Provisions of Companies Act deals with providing any loan or any guarantee / security in connection with loans of directors/ related entities, but does not cover promoter / promoter group, Key Management Person (KMP) etc. Since, providing of loan or any guarantee / security in connection with a loan creates an obligation on listed company, it is felt that necessary safeguards should be put in place before providing any such loan or any guarantee / security to any person (including promoter(s)/ promoter group, director, directors relative, KMP etc).
3. Guarantees provided by the companies should be in its economic interest, so that the interests of the shareholders are protected. General definition of 'economic interest' involves financial interest of the entity in investments, employment, awarding of contracts, purchases, leases, sales or other related transactions. However, a specific legal definition of "economic substance" is not readily available. Based on examination of various jurisdiction like USA along with Doctrine of Economic Substance, definition of economic interest may be evolved as follows:

*"An "Economic Interest" relates to income/ benefit derived from business/ non-business transactions of the listed entity, which may result into pecuniary benefit or otherwise. Further, any transaction involving "economic interest" of the listed entity shall necessarily cover the following scenarios:*

- *Have direct/ indirect financial implication on the business activity of the listed entity, which apart from monetary transactions may also include competitive position, employment, awarding of contracts, purchases, leases, sales or any other matter, and / or*
- *Have a reasonable possibility of generating direct or indirect benefits for the listed company*

*And the benefits of such transactions shall necessarily accrue to the shareholders of the listed entity."*

4. Companies Act, 2013 provides that special resolution is required for providing loan or any guarantee / security in connection with a loan above certain limit, however, there is a possibility that a listed company can extend



loan or any provide any guarantee / security in connection with a loan to any person or body corporate including promoter/ promoter entities without obtaining the shareholders' approval provided such loans/ guarantees/ security are within the said limits.

5. Companies Act, 2013 requires that rate of interest charged on loan shall not be lower than the prevailing yield of Government security closest to the tenor of the loan. However, such safeguards do not exist for extending loan or any guarantee / security in connection with a loan to promoter or promoter related entities. Thus the possibility of the entity being arm-twisted to provide a loan or a guarantee/ security in connection with a loan to facilitate the personal obligations of the promoter/ promoter related entities without any probable economic benefit of the company, cannot be completely ruled out. Given the fact such loans/guarantees/ security do not even require shareholders' approval below the prescribed threshold, such loans/guarantees/ security are prone to misuse at the expense of the minority investors of the listed companies

**Policy proposals:**

6. To protect the interests of minority shareholders, in addition to extant provisions of the Companies Act, 2013 and disclosure requirements of SEBI (LODR) Regulations, 2015, it is proposed that guarantee/ security can be extended by a listed entity, provided:
  - a. Extension of such guarantee/ security to any person / entity (promoter(s)/ promoter group/ director / directors relative / KMP etc) is in the 'economic interest' of the listed company.
  - b. The said listed entity shall obtain prior approval from the shareholders on a "majority of minority" basis, before extending any such loan or any guarantee / security.

**Public comments**

Comments on the above proposal may be sent on or before March 31, 2020 in the following format:

Name of entity / person / intermediary/ Organization:			
Sr. No.	Issues	Suggestions	Rationale



*Comments may be sent:*

1. By email to [guaranteereview@sebi.gov.in](mailto:guaranteereview@sebi.gov.in)
2. By post to the following address:

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