SINGAPORE INSTITUTE OF DIRECTORS

STATEMENT OF GOOD PRACTICE

SHARE PLEDGING BY DIRECTORS WHO ARE CONTROLLING SHAREHOLDERS

Introduction

There had been instances in which shareholders who own a controlling portion of the shares of a listed company had entered into personal margin lending arrangements which involve pledging their shares in the listed company as collateral for cash.

In situations of a stock market downturn, the creditors of such shareholders may demand a margin call or require a mark to market top up of shares. Where the shareholder is unable to fulfill its obligations as a borrower, his pledged shares may be seized and/or force sold by the creditors. This may lead to circumstances where there is a change of shareholding control in the listed company where the shareholder is no longer a controlling shareholder. It may also cause a cross default trigger of covenants contained in credit facilities entered into between the listed company and other third parties. This may result in "event of default" situations thereby triggering acceleration of repayment of the listed company's indebtedness. If not handled properly, the listed company may find itself in a cash-flow or liquidity crunch. In view of such situations, amendments to the Listing Manual have been recently introduced.

In essence, the listing rules provide that if an issuer or any of its subsidiaries enters into a loan agreement or issues debt securities that contain a condition which makes reference to the shareholding interests of any controlling shareholder or restricts change of control of the issuer, and the breach of this condition or restriction will cause a default in respect of the loan agreement or debt securities, significantly affecting the operations of the issuer, it must immediately announce the details of such conditions or restrictions, and the aggregate level of these facilities that may be affected by a breach of the obligation.

Further, in case of such a loan agreement being entered into, the issuer must also obtain an undertaking from its controlling shareholders to notify the issuer, as soon as it becomes aware, of any share pledging arrangements relating to these shares and of any event which may result in a breach of the issuer's loan covenants, followed by an immediate announcement of the details by the issuer.

Director's Prudence Is Essential

Whilst controlling shareholders exercise full proprietary rights over the shares owned by them in a listed company, they should exercise prudence in the private dealings with their shares. This is especially so where the controlling shareholders are directors of the listed company, as they owe fiduciary obligations to it. Any margin call or foreclosure on their pledged shares may have adverse impact on the financial position of the listed company and may affect its liquidity and cash-flow position.

Directors should be mindful of their regulatory and legislative obligations and duties. In particular, directors' attention is drawn to the following:-

(a) **Compliance with Legislation**: Directors should be mindful of regulations and laws pertaining to insider trading in dealing with their shares in the listed company. Directors will have to ascertain the implications of dealing in their shares under the provisions of the Securities and Futures Act (Chapter 289) of Singapore and other relevant legislation.

(b) **Compliance with the Listing Manual**: Directors should also be reminded of the above amendments to the Listing Manual. Directors who are the controlling shareholders of the issuer will have to ensure the compliance with the undertaking they had provided and the disclosure and notification requirements contemplated by the amended Listing Manual while dealing with their shares.

In the event of any doubt, management shareholders who are directors should seek professional advice in their personal capacity.
