

Sale of pledged securities: The Securities and Exchange Board of India reiterates contract law safeguards

On February 5, 2026, the Securities and Exchange Board of India (the “SEBI”) issued a circular to all the depositories titled ‘Creation/Invocation of pledge of securities through depository system’ (the “Circular”). The Circular reiterates certain procedural safeguards in respect of invocation of a pledge of securities and subsequent sale of such securities. The provisions of the Circular is required to be implemented by the depositories on or before April 6, 2026.

Background

The existing framework for creating a pledge of securities is governed under the Depositories Act, 1996¹ (the “**Depositories Act**”), the SEBI (Depositories and Participants) Regulations 2018² (the “**DP Regulations**”), the Master Circular for Depositories³ dated December 3, 2024 and the bye-laws of National Securities Depository Limited (the “**NSDL**”) and Central Depository Services Limited (the “**CDSL**”). Broadly, the regulatory framework provides that a beneficial owner can create a pledge over the securities by issuing the relevant instructions to the depository which is then required to lien mark a pledge in the records within 15 (fifteen) days of the request. Subject to the provisions of the pledge document, the pledgee may invoke the pledge and on such invocation the depository is required to register the pledgee as the beneficial owner and update its records. Both the pledgor and the pledgee will be informed of such invocation by the depository participant. The current framework does not expressly stipulate the requirement of providing a notice to the pledgor before the sale of the pledged shares by the pledgee.

Keys changes under the Circular

The Circular makes the following changes to the legal framework:

1. Changes to the pledge request form:

The Circular requires the CDSL and NSDL (collectively, the “**Depositories**” and individually, a “**Depository**”) to modify the pledge request form (i.e., the form lodged with the depositories to create a pledge). It provides that the pledge request form must include an undertaking: (a) from the pledgee that reasonable notice will be given

¹ <https://www.sebi.gov.in/legal/acts/sep-1995/depositories-act-1996-as-amended-by-the-international-financial-services-centres-authority-act-2019-w-e-f-october-01-2020-1.html>

² <https://www.sebi.gov.in/legal/regulations/nov-2025/securities-and-exchange-board-of-india-depositories-and-participants-regulations-2018-last-amended-on-november-22-2025-98196.html>

³ <https://www.sebi.gov.in/legal/master-circulars/dec-2024/master-circular-for-depositories-89245.html>

to the pledgor and that Sections 176 and 177 of the (Indian) Contract Act, 1972 (the “**Contract Act**”) will be complied with; and (b) from both the pledgor and pledgee that they will abide by the Contract Act, the Depositories Act, the DP Regulations, circulars, and applicable bye-laws.

For context, Section 176 of the Contract Act provides that, upon the pledgor (i.e., pawnor) defaulting in the repayment of debt, and/or performance of obligations relating to the pledged goods. In such a case, the pledgee may, *inter alia*, sell the pledged goods on giving the pledgor reasonable notice of the sale.

Section 177 of the Contract Act entitles the pledgor to redeem the pledged goods at any subsequent time before their actual sale provided the pledgor pays any additional expenses which have arisen from the default.

2. **Standardisation of the pledge request form:**

The next change is the standardisation of the pledge request form across both the Depositories. Currently, each Depository have their own formats of the pledge request form. The Circular mandates that both Depositories standardise and adopt a common form, ensuring consistency and removing the scope for ambiguity and interpretation.

3. **Mandatory intimation by Depositories on invocation:**

The Circular also introduces an additional compliance measure in the form of a notice which must be issued by the Depository upon the invocation of a pledge. It provides that the Depository must issue a notice to both the pledgor and pledgee recording the fact that the pledge has been invoked and that the pledgee has been recorded as the beneficial owner of the shares/securities.

Analysis

1. It is pertinent to note that Section 176 of the Contract Act provides for notice to be given prior to ‘selling’ the goods pledged. Similarly, Section 177 of the Contract Act entitles the pledgor to redeem/reclaim the goods at any time prior to ‘actual sale’ upon payment of monies (and other expenses) advanced by the pledgee. This admits of 2 (two) possible interpretations:
 - a) ‘Sale’ means ‘sale to a third-party’. If the pledgee that has been registered as the beneficial owner intends to sell the shares to a third-party, the pledgee is required to provide a reasonable notice of sale to the pledgor, and the pledgor is entitled to reclaim the shares after payment of the dues; and
 - b) ‘Sale’ means ‘transfer of beneficial ownership of the shares to the pledgee’. It would require the pledgee to furnish notice to the pledgor prior to invocation of the pledge (i.e., prior to the pledgee assuming beneficial ownership of the shares).
2. The Supreme Court of India (“**Supreme Court**”) in *PTC India Financial Services Limited vs. Venkateswarlu Kari and Ors⁴*, (“**PTC Case**”), has settled certain aspects of this question by, *inter alia*, stating that:
 - a) a pledgee has a special right and not a general right in the pledged property, i.e., the pledgee does not have the right of ownership but offers a limited right to retain possession and right of disposition/sale till the debt is paid or promise is performed;
 - b) the term ‘sale’ under Sections 176 and 177 of the Contract Act means ‘an actual sale to a third-party’. A sale-to-self, or the transfer of beneficial owner to the pledgee does not result in an ‘actual sale’ as the pledgee does not receive any money which he can adjust against the debt due. Such transfer of beneficial owner to the pledgee is a conversion;
 - c) a notice of sale to the pledgor prior to the consummation of sale of the pledged securities is mandatory. It noted that prior notice under Section 176 of the Contract Act would not interfere with transparency and

⁴ (2022) 9 SCC 704

certainty in the securities market and would not have the effecting of rendering a blow to the Depositories Act and the DP Regulations. It ruled that that the objective of a pledge is to realise money on sale of the security for the pledgee and not a purchase of the security by the pledgee; and

- d) while distinguishing an earlier judgment of the Delhi High Court, the Supreme Court appeared to indicate that the right to follow the property in the hands of the third-party buyer may not apply in the context of sale of listed shares. The court argued open market operations would be impacted otherwise.

Conclusion

1. The Circular reiterates the basic contract law principles of issuing a 'reasonable notice' and following procedural safeguards prior to the consummation of sale of the pledged securities. It does not appear to create any exceptions for listed securities and/or unlisted securities.
2. If one goes by the Supreme Court's interpretation in the PTC Case, then the pledgee is required to issue this 'reasonable notice' to the pledgor prior to sale of the pledged securities to a third party. Therefore, the mere invocation of pledge does not end the possibility of litigation (by way of interim orders of a court and/or tribunal) and/or settlement proceedings, that can be initiated by the pledgor. There is, therefore, an unaddressed risk of legal action by pledgor at the point of sale. This risk becomes more pronounced as time passes. A better strategy may therefore be to sell the pledged shares immediately after invocation of the pledge and not harvest it on the books of the pledgee for too long.
3. The Circular does not clarify what constitutes a 'reasonable period' for the service of notice. In the absence of guidance from the Depositories, the most prudent approach would be to expressly include a 'reasonable period' within the contract itself. Doing so would ensure adherence to principles of due process and procedural fairness.

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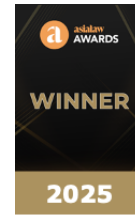
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