

## Corpsec Hotline

March 05, 2004

### ADVENT OF INDIAN DEPOSITORY RECEIPTS

The Department of Company Affairs ("DCA") has finally issued the much-awaited Companies (Issue of Indian Depository Receipts) Rules, 2004 ("Rules"), which paves the way for foreign companies to make public offers of Indian Depository Receipts ("IDRs"). The DCA had earlier prepared a draft Companies (Issue of IDRs) Rules, 2002 ("Draft Rules").

#### Eligibility Criteria

The Rules lay down the following eligibility criteria for foreign companies who intend to issue IDRs:

- The pre-issue net worth of the companies should be at least US\$ 100 million and its average turnover should be US\$ 500 million during the 3 financial years preceding the issue;
- The issuing companies should be making profits for the last five years preceding the issue and have a ten percent dividend pay out record;
- Its pre-issue debt equity ratio should not be more than 2:1.

Additionally, the issuing companies shall also have to comply with any criteria stipulated or any regulations formed, by the Securities and Exchange Board of India ("SEBI") in this regard.

The eligibility criteria are mostly the same as were laid down in the Draft Rules and are rather stringent and prohibitive in providing for the net worth and turn over criteria. Most foreign companies may also not be able to satisfy the dividend criteria as foreign companies typically re-invest their profits into the business as opposed to Indian companies, which are used to declaring dividends out of profits.

One criterion from the Draft Rules has been excluded, which is the issuing company had to be listed in an international stock exchange.

The issuing company has to list on one or more stock exchanges in India having nationwide trading terminals, which means the Bombay Stock Exchange, National Stock Exchange or both. The listing requirement implies that currently, privately placed IDRs may not be possible.

#### Procedural Requirements

The issue of IDRs may require approvals from the Ministry of Finance, SEBI and from local securities authorities, such as the SEC in USA.

The IDRs are not redeemable into the underlying equity shares for a period of one year from the date of issue. Further, the IDRs issued shall not exceed fifteen percent of the company's post issue net worth and the IDRs have to be denominated in Indian Rupees, irrespective of the denomination of the underlying securities.

Various documents have to be filed with SEBI and the Registrar of Companies, viz., the constitution of the company; laws governing the incorporation of the company; address of a principle place of business in India; if there is no place of business in India, then address for public inspection of documents in India certificate of incorporation of the issuing company; copies of agreements entered into by the issuing company, the overseas custodian bank, the domestic depository, which shall *inter alia* specify the rights that are to be passed on to the IDR holders.

#### Persons Eligible to Purchase IDRs

"Persons Resident in India" as defined under the Foreign Exchange Management Act, 1999 are eligible to purchase IDRs and this includes any person or body corporate registered or incorporated in India. This could mean that apart from individuals and companies, even Foreign Institutional Investors should be eligible to purchase IDRs. However, Foreign Venture Capital Investors and Venture Capital Funds would not be eligible to invest, as the current regulations governing them permit them to invest only in IPOs of domestic companies.

#### Tax and other Issues

The payment of dividend to the IDR holders will give rise to withholding tax and tax credit issues for Indian residents.

IDR holders could have voting rights if the issuing company so desires. The accounts of the issuing company may have to be recast as per the SEBI's guidelines or the listing agreement, so that they are in tune with Indian accounting practices and easier for investors to understand.

IDRs will open up new avenues for foreign companies wanting to acquire or takeover Indian companies. This will facilitate stock-swap transactions where Indian promoters have to be offered stock in foreign companies in excess

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of **current limit of US\$25,000.**

The IDR route would be attractive for small and mid-cap foreign companies, typically based in the USA and South East Asia, which are familiar with Indian markets or have promoters of Indian origin. Also, India is an interesting listing option considering the costs of listing and potential valuations that can be achieved. There is scope for changes in the Rules considering the dynamics and working of international markets and companies. Nevertheless, this is a bold move by the Government to further open the Indian capital markets to the world.

*You can direct your queries or comments to **Ruetveij Pandya***

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