

Asia and the Pacific

INDIA

Regulators Ease Rules On Investments In Foreigners' Indian Depository Receipts

By Shikhar Kacker and Vyapak Desai, of Nishith Desai Associates, Mumbai. The authors may be contacted by E-mail at shikhar@nishithdesai.com and vyapak@nishithdesai.com.

The Reserve Bank of India ("RBI") vide its Circular RBI/2009-10/106 A.P. (DIR Series) Circular No. 05 dated July 22, 2009 ("Circular") has provided much needed clarity for foreign companies ("Issuing Company") desirous of issuing Indian Depository Receipts ("IDRs"). Consequential amendments will be made to the relevant provisions of the Foreign Exchange Management Act, 1999 ("FEMA") and regulations issued thereunder.

The Circular attempts to align the regulatory framework of RBI governing IDRs with the recent proactive measures taken by the Ministry of Corporate Affairs ("MCA") and the Securities and Exchange Board of India ("SEBI"). The implications of the Circular are analyzed below.

Financial/Banking Companies Having Presence In India Required To Obtain Prior Approval For Issuance Of IDRs

The extant Companies (Issue of Indian Depository Receipts) Rules, 2004 ("IDR Rules") and SEBI (Disclosures and Investor Protection) Guidelines, 2000 ("DIP Guidelines") do not require an Issuing Company to seek any specific approval from the sectoral regulator(s) prior to the issuance of IDRs. RBI in the Circular has created an exception for financial and banking companies and requires foreign financial and banking companies having a presence in India, either through a branch or a subsidiary, to seek prior approval of the sector regulator(s) before the issuance of IDRs.

Implications

RBI has always regarded banking and financial services as a sensitive sector of the Indian economy. In fact, even Indian entities intending to engage in financial services activities in overseas jurisdictions are required to adhere to certain specific requirements and seek prior approval from the concerned sectoral regulator(s). The caution that RBI exercises over the financial and banking sector is evident from the Circular, as financial and banking companies would be required to seek prior approval from the sectoral regulator(s) prior to the issuance of IDRs. For example, a banking company having a subsidiary/branch in India and desirous of issuing IDRs would be required to seek prior approval from RBI.

Repatriation Of IDR Issue Proceeds

Under the IDR Rules, the IDR issue proceeds collected by the domestic depository are repatriable in favour of the Issuing Company after conversion into foreign currency, subject to the laws relating to the export of foreign exchange. In the absence of specific guidelines by RBI in this regard, the procedure for repatriation of IDR issue proceeds was imprecise. The Circular provides that the proceeds of the issue of IDRs are to be immediately repatriated outside India by the Issuing Company.

Period Of Redemption

In January 2009, pursuant to amendments to the IDR Rules, the one year lock-in period on redemption of IDRs into underlying equity shares of the Issuing Company from the date of issue of the IDRs was done away with. However, the joy of investors would be a short-lived one, as the Circular has once again provided for lock-in on redemption of underlying equity shares of the Issuing Company into IDRs before the expiry of one year from the date of issue of the IDRs.

Implications

The re-introduction of lock-in requirements for redemption of IDRs for underlying equity shares of the Issuing Company would once again impose restriction on the flexibility and liquidity to investors.

Investment By Persons Resident In India, Foreign Institutional Investors And Non-Resident Investors

Initially, under the IDR Rules, only resident Indians could invest in IDRs. However, in January 2009, the MCA permitted issuance of IDRs to persons other than persons resident in India. Later, SEBI in June 2009 notified relaxations in favour of Foreign Institutional Investors ("FIIs"), Non-Resident Investors ("NRIs") and domestic mutual funds and permitted them to invest in IDRs subject to the provisions of FEMA. The Circular proposes to make express provisions in the necessary regulations issued under FEMA for permitting FIIs, including their sub-accounts, and NRIs to invest in IDRs.

Implications

The relaxations made by SEBI in June 2009 were subject to FEMA, which did not contain explicit provisions providing for IDRs as securities in which investments could be made by FIIs and NRIs. The Circular provides the necessary clarity to FIIs and NRIs for making investments in IDRs under the automatic route, *i.e.*, without prior approval of RBI.

Fungibility

Under the DIP Guidelines, automatic dual fungibility of IDRs is not permitted, *i.e.*, conversion of underlying equity shares of the Issuing Company into IDRs. This requirement of SEBI has been confirmed by RBI in the Circular and has provided a prohibition on automatic fungibility of IDRs.

Procedure For Transfer And Redemption Of IDRs

There existed an element of ambiguity as to the exchange control implications upon redemption of IDRs into underlying equity of the Issuing Company.

As per the Circular, the guidelines for holding underlying equity shares of the Issuing Company after redemption of IDRs are provided below:

Listed Indian Companies

Under the extant provisions of FEMA relating to overseas direct investments, a listed Indian company is permitted to invest up to 50 percent of its net worth as of the date of the last audited balance sheet in 1) shares, and 2) bonds/fixed income securities, rated not below investment grade by accredited/registered credit rating agencies, issued by listed overseas companies. Separately, certain additional requirements are imposed on a person seeking to make investment in an entity engaged in the financial services sector.

As per the Circular, a listed Indian company can sell or continue to hold underlying equity shares of the Issuing Company subject to the terms and conditions of FEMA provisions relating to overseas direct investments.

Domestic Mutual Funds

Presently, the extant provisions of FEMA relating to overseas direct investments permit investment by domestic mutual funds in certain specified securities of an overseas company listed on a recognized stock exchange or in exchange traded funds. In this regard, SEBI in June 2009 included IDRs as securities in which investments can be made by domestic mutual funds.

As per the Circular, domestic mutual funds are permitted to sell or continue to hold underlying equity shares of the Issuing Company, till such time they are compliant with the provisions relating to overseas direct investments under FEMA.

Other Resident Persons

The current exchange control regulations provide limited routes for Indian investors to invest in securities of foreign companies through the Liberalized Remittance Scheme ("LRS") of RBI and funds paid out of a Resident Foreign Currency Account ("RFC Account"). Until now, it was unclear whether a resident person could invest in foreign securities without prior approval of RBI, by virtue of redemption of IDRs for their underlying equity shares.

As per the Circular, resident individuals are allowed to hold the underlying shares only for the purpose of sale within a period of 30 days from the date of conversion of the IDRs into underlying shares of the Issuing Company.

Further, the Circular clarifies that FEMA provisions relating to foreign investments in India would be applicable to FIIs/sub-accounts only as long as they stay invested in IDRs. Upon redemption of IDRs for the underlying equity shares of the Issuing Company, the FII/sub-

account would be regarded as the holder of foreign securities, and thus outside the purview of RBI.

Implications

IDRs have an inherent feature of being redeemed for the underlying equity shares of the Issuing Company at the option of the investor, thus entitling the investor to the equity shares of a foreign company at his will. The Circular provides much needed clarity on the implications of holding equity shares of a foreign company, which an investor would be entitled to hold after its redemption for IDRs.

Conclusion

From the recent amendments, it can be said that the Government and regulatory authorities, *viz.*, RBI and SEBI, have been taking progressive steps to facilitate issuance of IDRs by doing away with several stringent requirements that were applicable to certain categories of investors, that is, NRIs, mutual funds and FIIs. These regulations hitherto prevented them from investing in IDRs and introducing clarity in respect of procedural requirements for redemption of IDRs and repatriation of IDR issue proceeds. The amendment indicates positive steps by the Government and regulatory authorities to make IDRs a reality.

SINGAPORE

Enhanced Shareholder Rights To Be Considered In Consultation

By Ang Cheng Hock SC and Yap Lune Teng, of Allen & Gledhill LLP, Singapore. The authors may be contacted by E-mail at ang.chenghock@allenandgledhill.com and yap.luneteng@allenandgledhill.com.

In a speech delivered on July 18, 2009, at the Asian Investment Conference & Exhibition 2009, Minister in Prime Minister's Office and Second Minister for Finance and Transport Mrs. Lim Hwee Hua disclosed that the Steering Committee for Reviewing the Companies Act (the "Steering Committee") will be releasing a draft Companies (Amendment) Bill for public consultation by 2010.

Mrs. Lim highlighted three issues regarding shareholder rights that the Steering Committee for Reviewing the Companies Act has studied and which will be discussed in the consultation papers. These areas are:

- appointment of multiple proxies;
- investor rights for Central Provident Fund investors; and
- minority shareholder protection.

Appointment Of Multiple Proxies

In normal circumstances, it is sufficient and fair for an individual shareholder who is also the registered member to have two proxies. Consistent with this, the Companies Act provides that a member is entitled to appoint