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ADR/GDR holders may get more say

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MumbaiIndian companies planning to issue shares overseas will have to be more careful now. The Securities and Exchange Board of India (Sebi) plans to allow holders of American depository receipts (ADR) and global depository receipts (GDR) to decide on how they want to vote. Basically, this means unlike the present practice, companies will not have the right to include any “terms of issue” clauses that empower the management to exercise voting rights or which restrict the voting rights of ADR/GDR holders.

ADRs and GDRs are receipts issued by banks against shares of Indian companies abroad. Exchanges allow these receipts to be listed and traded like shares. The change will bring the treatment of ADR/GDR similar to the practice currently followed by the US.

“It is a logical extension of Sebi’s earlier amendment, bringing depository receipts (DRs) with voting rights under the ambit of takeover regulations. This will create a more level-playing field between equity shareholders and depository receipt holders,” said Siddharth Shah, principal and head of corporate and securities practice group, Nishith Desai Associates. The latest move by Sebi is a sweeping change that will check management gaining excessive management control (over the company) and further strengthen corporate governance standards.

The regulator in its board meeting held last week in Mumbai noted that the right to give instructions to the custodian bank for exercise of voting rights is vested in some cases with the board of directors of the issuer company.

Sebi named few Indian companies like Federal Bank, KS Oils, Webel-SL Energy Systems and Suzlon Energy, which have issued depository receipts curtailing the voting rights of depository receipt holders. This was in accordance with the “terms of issue” clause included by these companies while issuing GDR/ADRs. In several cases, where the “terms of issue” is unilaterally decided by the management of the issuer, Sebi felt that an investor had no choice but to accept the terms if he was interested in subscribing to the receipts.

For the uninitiated, when depository receipts are issued, the underlying shares are deposited with a local custodian bank whose name is entered in the register of members of the issuer company. And as a business arrangement, the domestic custodian bank exercises the voting rights, which in turn is indirectly governed by the terms of the depositary agreement. The terms of issue varies from issuer to issuer.

“It is for consideration whether, as a matter of good governance, it is advisable to restrict issuers from including as “terms of issue” clauses that curtail the voting rights of depository receipt holders and which empower the management to exercise voting rights on DRs,” Sebi has said while pointing out that the US SEC has such a provision.

Since the provision relating to issue of ADR/GDRs are within the administrative control of the finance ministry and RBI, the market regulator is expected to approach the government for a policy change in this regard.

This is the second time in less than a year that the regulator is plugging the loopholes in DR issuances. In September 2009, Sebi amended the takeover regulations when Bharti Airtel was planning to divest 36% stake in favour of South African telecom major MTN and its shareholders through GDR issues in return for a 49% stake in MTN. The amendment required DR holders having voting rights to make an open offer to the shareholders of the target company upon crossing the threshold limit.