

## Corpsec Hotline

July 18, 2007

### GETTING CLOSER TO INDIAN CAPITAL MARKETS: IDR NORMS RELAXED

The Ministry of Company Affairs, Government of India ("MCA") vide notification (No. GSR 480 (E) dated July 11, 2007 ("Notification") and Press Release dated July 17, 2007 ("Press Release") has liberalized the rules for the foreign companies / issuer companies ("Issuers") to raise money from the Indian capital market by issuing Indian Depository Receipts ("IDRs"). The said Notification makes certain amendments to the Companies (Issue of Indian Depository Receipts) Rules, 2004 ("Existing Rules"), which were issued on February 23, 2004. The amended Rules shall be called the Companies (Issue of Indian Depository Receipts) (Amendment) Rules, 2007 ("Amendment Rules"). Securities and Exchange Board of India ("SEBI"), as capital market regulator, had earlier issued a circular dated April 3, 2006 ("Circular") indicating other eligibility conditions for Issuers to issue IDRs. The Amendment Rules issued by MCA seek to align the provisions relating to the IDRs contained in the Existing Rules with those in the Circular issued by SEBI.

We had earlier circulated our Corpsec Hotlines "Advent of Indian Depository Receipts" dated March 5, 2004 and "Indian Depository Receipts have Arrived" dated April 4, 2006 to analyse the implications of the IDR regime in India for the Issuers. We now analyse some of the key amendments made vide the Amendment Rules. The highlights of the amendments are as follows:

#### Networth and Capitalization Ceilings

As per the Existing Rules, the Issuers can raise funds from the Indian capital market if they fulfill the minimum networth and turnover criteria i.e. the pre-issue paid up capital and free reserves are at least USD 100 million and the average turnover is atleast USD 500 million during the 3 financial years preceding the issue.

As per the Amendment Rules, Issuers having a pre-issue paid up capital and free reserves of at least USD 50 million with a minimum average market capitalization of at least USD 100 million, during the last 3 financial years preceding the issue, can issue IDRs.

*Implication: This change in eligibility criteria from "turnover" to "capitalization" is with a view to facilitate better reflection to the financial sustainability / liquidity of the securities to be issued by the Issuers. The reduction in net worth requirement would encourage Issuers with a lesser networth to have easy access to raising funds through the IDR route.*

#### Trading Track Record

As per the Existing Rules, there is no requirement for the Issuers to have a trading record on a stock exchange in their home country. However, the Circular issued by SEBI does provide for Issuers to be listed in their home country as one of the eligibility conditions.

As per the Amendment Rules, the Issuers would be required to have a continuous trading record or history on a stock exchange in its home country for at least 3 years immediately preceding the issue.

*Implication: The criteria that the Issuers should be listed in home country seems to be quite onerous since small and mid-cap companies familiar with the Indian markets and with promoters of Indian origin, which would want to list on Indian stock exchange may find it difficult to satisfy this condition on account of lack of financial capabilities to list in their home country.*

#### Profit Track Record

As per the Existing Rules, the Issuers who have made profits for at least 5 years preceding the issue, have declared dividends of not less than 10% each year for the said period and have a minimum of 2:1 debt equity ratio, can issue IDRs.

As per the Amendment Rules, the above onerous requirements have been relaxed to provide that the Issuers should now have a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least 3 out of immediately preceding 5 years. Further, the requirement of having a minimum of 2:1 debt equity ratio has been done away with.

*Implications: The reduction in number of years from 5 to 3 for determining profit track record has been made to bring the eligibility conditions at par with the conditions in this regard for domestic issues. Further, the amendment would be a step forward for Issuers, who may have adopted different dividend policies as per their business needs and as permissible in their home countries.*

#### Time Bound

As per the Existing Rules, the Issuers have to make an application to SEBI in order to seek permission for issuance of

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As per the Amendment Rules, a new procedure with respect to the approval by SEBI has been laid down with timelines prescribed for SEBI to dispose off the applications.

*Implications: This would lead to a quicker turn around of IDR applications by SEBI.*

### Post Issue Requirements

As per the Existing Rules, the IDRs issued by the Issuers shall not exceed 15% of their paid-up capital and free reserves in any financial year.

As per the Amendment Rules, the said limit of 15% has been increased to 25%.

*Implications: This would provide greater headroom to the Issuers to issue higher amount of IDRs.*

### Continuous Disclosures

As per the Existing Rules, the Issuers have to comply with the continuous disclosure requirements, which includes preparation of the quarterly audited results and publication of the same in newspapers in the manner specified by the listing conditions.

The Amendment Rules have relaxed the said obligation on the Issuers in light of the fact that auditing regulations in various jurisdictions do not provide for quarterly audited financial results and such publication may not take place in newspapers in the electronic era. Accordingly, the Amendment Rules provide that the quarterly audited results or unaudited results may be prepared and subjected to limited review by the auditors of the Issuers and approved by its board of directors and disclosed. The manner of publication has been left to be specified in the listing conditions to be laid down by the Indian stock exchange as per framework determined by SEBI.

*Implications: The relaxation of the disclosure norms would enable the Issuers not required to get their accounts audited on a quarterly basis as per their home country regulations to raise funds through the IDR route.*

### Trading History

The Existing Rules do not provide for making disclosures relating to the listing or trading history of the Issuers.

The Amendment Rules make it mandatory for the Issuers to make disclosures with respect to listing, trading history or history of the Issuers on all the stock exchanges, whether situated in the home country or elsewhere.

*Implications: This would ensure that full details with respect to the Issuers are available, thereby building investor trust and confidence.*

### General Information

In addition to the above amendments, the Issuers shall, when required, obtain the necessary approvals or exemptions from the appropriate authority from the home country under the relevant laws in relation to the issue of IDRs.

*Implications: This would ensure that the Issuers do not violate any local laws in their home countries in relation to the issuance of IDRs.*

The Issuers shall appoint an overseas custodian, a domestic depository and a merchant banker and may appoint underwriters registered with SEBI to underwrite the issue of IDRs.

*Implication: This would ensure that the Issuers have made all necessary arrangements for the funds to be raised through the IDR route.*

### Conclusion

The amendments introduced by MCA vide the Amendment Rules would bring the Indian capital market a step closer to international capital markets and prepare the ground for the emergence of an international financial centre in India. The small and mid-cap companies from US and South East Asia would be the ideal candidates for utilizing the IDR route. With the cost of compliance of listing on other international markets such as NYSE or NASDAQ on account of Sarbanes-Oxley legislation, listing on Indian capital markets could be an attractive option for such companies. In spite of the liberalized norms, it still needs to be seen as to how far have the foreign issuers been convinced to consider the Indian capital market as a worthy platform for raising funds!!!!

### Sources:

- [Press Release dated 17/07/2007 issued by the Ministry of Company Affairs](#)
- [Companies \(Issue of Indian Depository Receipts\) Rules, 2004](#)
- [Companies \(Issue of Indian Depository Receipts\) \(Amendment\) Rules, 2007](#)
- [SEBI circular on new Chapter VI A of DIP Guidelines dated April 3, 2006](#)
- [SEBI circular on the IDR Listing Agreement, April 3, 2006](#)

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You can direct your queries or comments to the authors

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