

**DR ISSUANCES: ANALYSIS OF SEBI DR CIRCULAR****1. INTRODUCTION**

SEBI, through its circular dated October 10, 2019 has laid down a framework for issue of depository receipts (“DRs”) by listed companies and to be listed companies in order to provide increased access to foreign funds (the “SEBI DR Circular”). The framework comes shortly after Finance Minister Nirmala Sitharaman’s statement in August that the markets regulator would soon implement the Depository Receipt Scheme, 2014 notified by the Ministry of Finance in 2014 (the “MoF Scheme”).

DRs are foreign currency denominated instruments, issued by a foreign depository backed by securities of an issuer, issued or transferred to a domestic custodian and are listed on an international exchange.

The MoF Scheme, though a generously liberalized scheme for Indian companies, was never fully operationalized, resulting in unavailability of DRs as a fund-raising option. Additionally, identification of beneficial ownership norms for the longest time kept the route unattractive for foreign investors and depositories. However recently, the amendment to the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 (the “PML Rules”) on September 18, 2019 on the identification of beneficial owners paved the way for DRs (the “Amendment”).

**2. REGULATORY BACKGROUND**

Issue of DRs is primarily governed by the Companies Act, 2013 (the “Companies Act”) read with the Companies (Issue of Global Depository Receipts) Rules, 2014 (the “GDR Rules”), the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (the “FEMA Rules”), and the MoF Scheme.

Initially, the issue of DRs were regulated by the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 (the “1993 Scheme”), which has been repealed (except for issue of FCCBs) by the MoF Scheme. However, unlike the SEBI DR Circular, the 1993 Scheme was largely unregulated by SEBI.

**3. SEBI DR CIRCULAR: ANALYSIS****3.1. Key tenets of DRs****(a) International exchanges and jurisdictions**

DRs are allowed to list on international exchanges in permissible jurisdictions. A list of permissible jurisdictions and international exchanges therein are notified by Ministry of Finance and SEBI, respectively, through their notifications dated November 28, 2019.

List of permissible jurisdictions and international exchanges are as:

Sl. No.	Permissible Jurisdiction	International Stock Exchange
1.	United States of America	NASDAQ Stock Market The New York Stock Exchange
2.	Japan	Tokyo Stock Exchange
3.	South Korea	Korea Exchange Inc.
4.	United Kingdom <i>excluding British Overseas Territories</i>	London Stock Exchange
5.	France	Euronext Paris
6.	Germany	Frankfurt Stock Exchange
7.	Canada	Toronto Stock Exchange
8.	International Financial Services Centre in India	India International Exchange NSE International Exchange.

Further, within the specified international exchanges, only the highest level of DR programs are permitted (for example Level III ADR program on NASDAQ or NYSE) which require highest level of disclosure. Accordingly, Level I and II ADR programs which contains lesser amount of compliance and regulatory oversight have been disallowed. This could act as a disincentive given that lower disclosure and compliance standards are permitted in those jurisdictions and are acceptable to foreign investors.

Also, while the MoF Scheme mandated compulsory listing of DRs in case of unsponsored DRs (defined below), the SEBI DR Circular has made listing for all DR issuances by listed and to be listed issuers compulsory.

**(b) Permissible securities**

The SEBI DR Circular only allows equity shares and debt securities listed on an Indian stock exchange to be the underlying securities for DRs. This is in contrast to the MoF Scheme, which gave a more expansive definition of securities, including units of real estate investment trusts (REITs) and infrastructure investment trusts (InvITs).

**3.2 Eligibility**

Under the SEBI DR Circular, any issuers, its promoters, promoter group, directors and selling shareholders who are debarred from accessing capital markets and are declared as willful defaulters or fugitive economic offender are ineligible to undertake a DR issue. This is stricter than the eligibility criteria prescribed under the MoF Scheme. For example, the debarment test is only applicable to issuers and selling shareholders under the MoF Scheme, compared to the wider net of individuals and entities captured under the SEBI DR Circular.

Further, the eligibility conditions in case of fast track rights issues and public offers provide for a look back period of three years and excludes imposition of monetary fines by stock exchanges, while seeking compliance with SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the “LODR”). However, similar concessions have not been provided in the eligibility conditions prescribed under the SEBI DR Circular.

### 3.3 Compliance with Minimum Public Shareholding (“MPS”) norms

As an eligibility condition, a listed issuer proposing to issue DRs should be in compliance with the LODR in relation to the MPS requirement of 25% of the post issue capital, as given under the Securities Contract Regulation Rules, 1957 (the “SCRR”). Under the SEBI DR Circular, DRs are excluded from computing towards public shareholding, a departure from the MoF Scheme and the SCRR, wherein DRs were included. This could pose a significant challenge for companies intending to list DRs through fresh issuance, or DRs through secondary sale by non-promoter group, which could lead to higher than expected dilution to public by an issuer. Further, it needs to be seen if stock exchanges are agreeable to issuing in-principle approvals to issuers who have made a public offer of only 10% of the post issue capital to public (in accordance with SCRR) and are yet to increase it to the mandatory 25% of the post issue capital.

### 3.4 DR issuances

The issue of DRs can be offered through fresh issue or through transfer by existing security holders, as long as it complies with the foreign investment limits imposed under the FEMA Rules.<sup>1</sup> In case of issue and listing of DRs pursuant to transfer by existing holders, the issuer must provide an option to all existing security holders to take part in the process by tendering their securities – however, no procedure has been laid out under the SEBI DR Circular.

Further, an unsponsored DR as per the MoF Scheme is a program where DRs are issued without specific approval of the issuer. Thus, unsponsored DRs provide an additional avenue for investors on the back on underlying securities by creating a market overseas. However, the SEBI DR Circular has removed such flexibility.

### 3.5 Identification of beneficial owner

A permissible holder of a DR includes a beneficial owner, who is neither a person resident in India nor an NRI. Identification of beneficial owner will now be governed by the norms of the jurisdiction where the DRs will be listed, i.e. to say a foreign investor can acquire a DR based on the KYC checks it has undergone with the notified international exchange. However, the identification of beneficial owners under the Companies Act is at divergence when compared with the identification pursuant to the Amendment. To that extent, policy alignment is still a much-needed request.

### 3.6 Simultaneous listing outside and within India

The SEBI DR Circular permits simultaneous listing of DRs and permissible securities on Indian stock exchanges wherein the issue or transfer of the DRs can only happen after trading approval has been received from the Indian stock exchange for the public offer.

This may however pose a challenge in case of a secondary DR issue with respect to the pre-IPO shares locked in under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (the “ICDR Regulations”). Also, in case of further issue of permissible securities for issue of DRs, the capital structure of the issuer will remain fluid, which will require

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<sup>1</sup> Although reference has been made in the SEBI DR Circular to the Foreign Exchange Management (Transfer of Issue of Security by a Person Resident outside India) Regulations, 2017, the same has been repealed by the FEMA Rules.

obtaining necessary clearance from SEBI both in terms of disclosures as well as restriction on further issue of capital under the ICDR Regulations.

### 3.7 Filing of offer documents for DRs

For issue of DRs, the preliminary offer document needs to be filed with SEBI and the Indian stock exchanges for their comments, along with filing of the final offer documents. This is in contrast to the MoF Scheme, which mandated mere filing of the offer documents with SEBI. Additional review requirements imposed under the SEBI DR Circular seems to be excessive legislation impacting the timelines for launch. Filing of offer document seems to be a varied practice when compared to the external commercial borrowings raised by an issuer through international capital markets, and foreign currency convertible bonds.

### 3.8 Disclosures on Indian stock exchange

All public disclosures made on the international exchange to comply with the norms of the permissible jurisdiction where the DRs will be listed, are also required to be filed on the Indian stock exchange as per the SEBI DR Circular.

### 3.9 Voting Rights

While all DR holders are allowed to vote through foreign depository, the discretion provided to foreign depository under the MoF Scheme to vote on such matters irrespective of instructions received from DR holders has been taken away under the SEBI DR Circular. This seems to be a step in the right direction, as it now prevents the foreign depository to vote on the instructions of the promoters, or management of an issuer.

### 3.10 Pricing

Under the SEBI DR Circular, the price of issue of DRs should not be less than the price for the public offer/ preferential allotment/ QIP that has been made to the domestic investors. In case permissible securities are transferred for the issue of DRs, the same should be issued at a price not less than the price of a corresponding mode of issue of permissible securities to domestic investors under the applicable laws. With lack of clarity on what would constitute a corresponding mode of issue, it could affect the manner in which the pricing occurs, especially in case of issue of DRs from existing security holders.

## 4. CONCLUSION

Overall, the SEBI DR Circular is a welcome step by SEBI to operationalize the MoF Scheme for listed and to be listed companies. In addition, clarity on beneficial ownership was a longstanding roadblock which has been eased through the Amendment. However, the SEBI DR Circular in its current state still requires certain modifications to offer DRs as a lucrative fund-raising option. Further, clarity in relation to the fungibility of DRs is still awaited and will be reviewed with much interest, given the lessons learnt with the fungibility of IDRs in the past. However, a major roadblock for the complete operationalization of the MoF Scheme is a framework for unlisted companies, constituting a majority of active fund seekers (esp. start-ups) who are eagerly awaiting to tap this route, for which a regulatory framework by Ministry of Corporate Affairs is awaited.

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