

Corpsec Hotline

August 12, 2008

ADRS/GDRs: PRICE IS RIGHT! & IDRS: MCA TO 'UNLOCK' THE 1 YEAR LOCK-IN ON CONVERSION

Keeping in mind today's grim global capital market scenario, the Government of India's ("GoI") Ministry of Finance ("MoF"), and more specifically the Department of Economic Affairs ("DEA"), in its [release](#) dated July 31, 2008, has proposed certain changes to the pricing of American Depository Receipts ("ADRs") and Global Depository Receipts ("GDRs") regime. We discuss the same below.

Background

Coming to the rescue of the Indian corporates who are facing challenges in raising funds abroad, the DEA has proposed certain changes to the pricing norms prescribed under the ADR and GDR regime.

The current pricing norms as prescribed under the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 ("Scheme") state that the price per ADR/GDR should be the higher of the following:

1. The average of the weekly high and low of the closing prices of the related shares as quoted on the stock exchange in the **six (6) months** preceding the relevant date; or
2. The average of the weekly high and low of the closing prices of the related shares as quoted on the stock exchange in the two (2) weeks preceding the relevant date.

The 'relevant date' in this context means the date thirty (30) days prior to the date on which the resolution authorizing such issuance is passed at a meeting of the shareholders of the issuing company as per Section 81(1A) of the Companies Act, 1956.

Proposed Change

It is proposed that the six (6) months period as mentioned under "1" above, shall now stand reduced to two (2) months average price preceding the relevant date. It is further proposed to modify the definition of "relevant date" to mean the date on which the resolution authorizing the issuance is passed at the board of directors' meeting of the issuing company as opposed to the date 30 days prior to the resolution passed at a shareholders general meeting.

Implications

- The proposed changes would certainly mitigate the pricing pressure on ADR/GDR issuance given the weakening of the markets over the last six (6) months. Further, it is likely that the price of shares over two (2) months may be relatively closer to the prevailing share price.
- As stated above, the relevant date is the date used for ascertaining the price of the issuance of ADRs/GDRs. This relevant date, in order to prevent market manipulation, is currently the date thirty (30) days prior to the date of the shareholders resolution authorizing the issuance of ADRs/GDRs. However, through the proposed amendment, the relevant date has been shifted to a point closer in time to the actual issuance of the securities.
- However, if the 'relevant date' is the date of the board meeting, as proposed, then Kartik Ganapathy, Head of M&A Practice feels that, "there might be a room for market manipulation, which SEBI wishes to avoid in the interest of the investors at large". The change however allows the board of a company to optimize the pricing of such issuances and is therefore, a welcome move.

IDRs: MCA to 'unlock' the 1 year lock-in on conversion

The Indian Depository Receipts ("IDRs") regime was introduced through the Companies (Issue of Indian Depository Receipts) Rules, 2004 ("Rules"). In spite of their promulgation in 2004, the same haven't gained much popularity. In order to make the IDR route more lucrative for foreign companies who wish to list on the Indian bourses, the Ministry of Corporate Affairs ("MCA") has been in the continuous process of [relaxing](#) the Rules.

Background

The Rules provide for a one (1) year lock-in period as determined from the date of the issuance of the IDRs for the purpose of their conversion into the underlying equity shares of the issuing company. This provision was included in order to restrict an investors' early exit.

Proposed change

The MCA has [proposed](#) that the aforesaid one (1) year lock-in period on the conversion or redemption of the IDRs

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into equity shares should be removed.

Implication

- As stated above, the lock-in provision was created to restrict any conversions or redemptions that would lead to any early exit by an IDR-holder thereby providing some stability to the IDR. If the proposed change were to be effected, the IDR-holder would be in a position to redeem or convert the equity at their discretion, thus affording an increased liquidity. On the other hand, it would increase the fund out-flows from India as well as increase the exposure of Indian investors to foreign securities.
- Kartik Ganapathy, Head of the M&A Practice is of the opinion that, "this proposed amendment can also be perceived to be a step towards full capital account convertibility, which is certainly desirable". However, the implications of this proposed amendment vis-a-vis other exchange control regulations would have to be assessed.

- **Diptee Deshpande & Amrita Singh**

You can direct your queries or comments to the authors

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