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FII-PEs' holdings set to change

Reeba Zachariah & Partha Sinha, TNN 24 September 2009, 01:10am IST

MUMBAI: Foreign funds and private equity investors may have to structure their deals in listed Indian companies differently once Sebi notifies the new takeover guidelines. On Tuesday, the market regulator brought the holders of global depository receipts (GDRs) and American depository receipts (ADRs) under the Takeover Code and allowed voting rights.

GDRs and ADRs are instruments that allow investors overseas to hold and trade in these receipts on foreign bourses. Usually a foreign bank acts as a custodian of equity shares of an ADR/GDR issuing company and issues tradable certificates against those shares.

Though these depositary receipts carry voting rights, the custodian bank of these receipts usually doesn't exercise the rights. Investors overseas are more interested in return on their investment rather than voting rights, say investment bankers. Otherwise, the bank votes in consonance with the company management.

Till now, institutional investors routing their investment through ADRs or GDRs were outside the Indian Takeover Code. Current rules require that if an acquirer's holding crosses 15% in a company, it would have to make an open offer for an additional 20% stake. This would now change. An acquirer's holding in a company through ADRs/GDRs will also be included while calculating the 15% threshold limit.

Often FIIs hold shares of a company and also hold ADRs/GDRs, taking the total holding to over 15% in the company's total equity capital. These FIIs will have to rework their holding in Indian companies to comply with the new rules.

"Considering that the proposed amendment will be effective on a prospective basis, any acquisition of GDRs (or ADRs), along with voting arrangement post the amendment, shall be clubbed with the equity shares directly held for the purpose of computation of threshold limits for the trigger of open offer requirement under the Takeover Code,'' said Vyapak Desai, head-capital markets practice, Nishith Desai Associates.

The new structure also plugs the options for regulatory arbitrage. "The new Sebi guidelines, has plugged the loophole in the structure and has created a level playing field between overseas investors and local ones,'' said Hitesh Jain, partner, ALMT Legal. Jain said FIIs would prefer their holding to be within the 15% trigger limit as any higher holding will lead to an open offer and a subsequent increase in the cost of holding for the fund.

The entry strategy of private equity funds into Indian companies could also change. For example, a fund taking exposure in a company through multiple channels like preferential allotment and GDRs/ADRs would have to work out the structure in such a way that its holding is within the 15% threshold limit, said a legal expert. "This is because private equity funds are strategic and long-term investors in a company and would l ke to have a say in the company's affairs,'' he added.