

Amendment to certain SEBI Regulations to facilitate IDR issue process

1.0 Objective:

1.1 The objective of this memorandum is to propose certain amendments in SEBI (Depositories and Participants) Regulations, 1996, SEBI (Foreign Institutional Investors) Regulations 1995, SEBI (Mutual Fund) Regulations, 1996 and SEBI (Custodian of Securities) Regulations, 1996 in order to facilitate the IDR issue process.

2.0 Background:

2.1 Based on suggestions from various Merchant Bankers with global presence and entities evincing interest in coming out with IDR issues, a Board Memo no. 72/2008 was placed before SEBI Board in its meeting held on August 13, 2008. The Board memorandum sought the in-principle approval of the board for the following:

- to carry out necessary consequential amendments in IDR Guidelines and IDR listing agreement, once the IDR Rules are amended by Ministry of Corporate Affairs (MCA) ;
- to waive of the requirement in SEBI DIP Guidelines for providing reconciliation statement with Indian GAAP, if the issuer is preparing the financial statements in accordance with IFRS and
- to simplify the listing requirements to the issuers from the countries which are the signatories of Multilateral Memorandum of Understanding (MMOU) of International Organization of Securities Commission (IOSCO).

These proposals were duly approved by the Board.

2.2 MCA is in the process of carrying out certain amendments to IDR Rules as suggested by SEBI. In the meantime, SEBI is in the process of amending the SEBI (DIP) Guidelines and issuing the revised listing agreement. While studying the legal requirements that would be attracted during the IDR issue process, it has come to notice that certain amendments to some of the SEBI Regulations (other than SEBI (DIP) Guidelines/Listing Agreement) are required to be carried out to bring clarity and to facilitate the IDR issue.

3.0 Amendment to SEBI (Depositories and Participants) Regulations, 1996:

3.1 At present, Regulation 27 of the SEBI (Depositories and Participants) Regulations, 1996 (DP Regulations) mentions that every depository shall, in its bye-laws, state the specific securities which are eligible for being held in dematerialised form in the depository. Regulation 28 enumerates the securities eligible for being held in dematerialised form in a depository. Though IDRs are securities as per Section 2(h) of Securities Contracts (Regulation) Act (SCRA), IDRs are not expressly mentioned in Regulation 28 as securities eligible for being held in dematerialised form in a depository. For the purpose of clarity, an amendment may be made in the DP Regulations to include IDRs as securities eligible for being held in dematerialised form in a depository.

3.2 Hence, it is proposed that Regulation 28 (a) of the DP Regulations may be amended by inserting the words “Indian Depository Receipts” after the words “debenture stock” and before the words “or other marketable securities of a like nature”.

4.0 Amendment to SEBI (Foreign Institutional Investors) Regulations, 1995:

4.1. As per present SEBI (DIP) Guidelines, at least 50% of the IDRs issued have to be subscribed to by Qualified Institutional Buyers (QIBs). FIIs and Mutual Funds being major constituents of QIB category, their participation is crucial for the IDR issues. On the matter of allowing FIIs to invest in IDRs, it was decided at the HLCCFM in its meeting held on December 22, 2008 that the FIIs would be permitted to invest in IDRs and it is understood that the RBI is in the process of issuing necessary circular in the matter.

4.2 At present, as per Regulation 15 (1) (a) of SEBI (Foreign Institutional Investors) Regulation (FII Regulations), FIIs may invest inter-alia in securities in the primary and secondary markets including shares, debentures and warrants of companies unlisted, listed or to be listed on a recognised stock exchange in India. As per Companies Act, 1956, “company” means a company formed and registered under the Companies Act, whereas issuers of IDRs being invariably entities incorporated outside India would be “body corporate” as per the definition of the Companies Act, 1956. Therefore to enable FII investment in IDRs, amendment may be required in the FII Regulations.

4.3. It is proposed that Regulation 15 (1) (a) of FII Regulations may be amended by suitably for the purpose.

5.0 Amendment to SEBI (Mutual Fund) Regulations, 1996:

5.1 At present, as per Regulation 43 (1) of SEBI (Mutual Fund) Regulations, 1996 (MF Regulations), Mutual Funds may invest moneys collected under any of its schemes in securities. However, the MF Regulations also separately list out privately placed debentures, securitised debt instruments

etc. as eligible instruments for mutual fund investment though such instruments fall within the definition of securities. In view of this and in order to bring in clarity, though IDRs fall within the definition of Securities as defined in Section 2 (h) of

SCRA, it is proposed to expressly include IDRs as eligible instrument for investment by Mutual Funds.

5.2 It is proposed that Regulation 43(1) of MF Regulations may be amended by inserting a sub-clause “(f) Indian Depository Receipts” after sub-clause (e).

6.0 Amendment to SEBI (Custodian of Securities) Regulations, 1996:

6.1 As per Rule 3 (i) (b) of IDR Rules, “Domestic Depository” means “custodian of securities” registered with SEBI and authorised by the issuing company to issue Indian Depository Receipts. IDR Rules further provide for certain role for “Domestic Depository” such as enabling the investors to redeem the IDRs, distribution of dividend and other corporate benefits, etc. to IDR holders. It may be noted that Regulation 2 (d) & Regulation 2 (e) of the SEBI (Custodian of Securities) Regulations, 1996 (Custodian Regulations) define “custodian of securities” and “custodial services” respectively. Custodian regulations having been framed long before IDRs were envisaged do not contain reference to role of custodian with respect to the issuance of Depository Receipts by custodians. It is therefore necessary to make amendments in the Custodian Regulations to enable the custodians to issue Indian Depository Receipts and to perform functions envisaged for “Domestic Depository” under IDR rules.

6.2 It is proposed that Regulation 2 (e) of Custodian Regulations be suitably amended for the purpose of performing such activities as envisaged in the IDR Rules for the domestic depository.

7.0 Extract of relevant extant provisions of SCRA/IDR Rules/SEBI Regulations mentioned in the note is enclosed at Annexure A.

8.0 Proposal:

8.1 The Board is requested to

- consider and authorize the proposals contained in paragraph 3.2, 4.3, 5.2 & 6.2 above
- authorise the Chairman to take consequent steps to give effect to the decisions
- authorise the Chairman to notify the amendment to SEBI (Depositories and Participants) Regulations, 1996, SEBI (Foreign Institutional Investors) Regulations 1995, SEBI (Mutual Fund) Regulations, 1996 and SEBI (Custodian of Securities) Regulations, 1996 on the above lines after making incidental and consequential provisions therein.

Extract of relevant provisions in the Act/Rules/Regulations

1. Securities Contracts (Regulation) Act, 1956

Section 2 (h): “Securities” include—

- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
- (ia) derivative;
- (ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;
- (ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- (id) units or any other such instrument issued to the investors under any mutual fund scheme;
- (ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;
- (ii) Government securities;
- (iia) such other instruments as may be declared by the Central Government to be securities; and
- (iii) rights or interest in securities;

2. The Companies (Issue of Indian Depository Receipts) Rules, 2004

Rule 3 (1) (b) : “Domestic Depository” means custodian of securities registered with the Securities and Exchange Board of India, hereinafter referred to as SEBI and authorised by the issuing company to issue Indian Depository Receipts;

Rule 5 (2) (iii) : The issuing company shall deliver the underlying equity shares or cause them to be delivered to an Overseas Custodian Bank and the said bank shall authorize the domestic depository to issue IDRs;

Rule 10 (i) : A holder of IDRs may transfer the IDRs or may ask the Domestic Depository to redeem these IDRs, subject to the provisions of the Foreign Exchange Management Act, 1999 and other laws for the time being in force.

Rule 10 (ii): In case of redemption, Domestic Depository shall request the Overseas Custodian Bank to get the corresponding underlying equity shares released in favour of the holder of IDRs for being sold directly on behalf of Indian resident, or being transferred in the books of issuing company in the name of Indian resident and a copy of such request shall be sent to the issuing company for information.

Rule 13: On the receipt of dividend or other corporate action on the IDRs as specified in the agreements between the issuing company and the Domestic Depository, the Domestic Depository shall distribute them to the IDR holders in proportion to their holdings of IDRs.

3. SEBI (Depositories and Participants) Regulations, 1996:

Regulation 27: Every depository shall, in its bye-laws, state the specific securities which are eligible for being held in dematerialised form in the depository.

Regulation 28: The following securities shall be eligible for being held in dematerialised form in a depository:—

- (a) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;
- (b) units of mutual funds, rights under collective investment schemes and venture capital funds, commercial paper, certificates of deposit, securitised debt, money market instruments, Government securities and unlisted securities shall also be similarly eligible for being held in dematerialised form in a depository;
- (c) any other security as may be specified by the Board from time to time, by way of a notification in the Official Gazette and subject to such conditions as it may deem fit to impose.

4. SEBI (Foreign Institutional Investors) Regulations, 1995:

Regulation 15: (1) A Foreign Institutional Investor may invest only in the following :—

- (a) securities in the primary and secondary markets including shares, debentures and warrants of companies unlisted, listed or to be listed on a recognised stock exchange in India;
- (b) units of scheme floated by domestic mutual funds including Unit Trust of India, whether listed on a recognised stock exchange or not;
- (c) dated Government securities; and
- (d) derivatives traded on a recognised stock exchange;
- (e) commercial paper;
- (f) security receipts.

5. SEBI (Mutual Fund) Regulations, 1996

Regulation 43 (1) Subject to other provisions of these regulations, a mutual fund may invest moneys collected under any of its schemes only in—

- (a) securities;
- (b) money market instruments;
- (c) privately placed debentures;
- (d) securitised debt instruments, which are either asset backed or mortgage backed securities; or
- (e) gold or gold related instruments.

6. SEBI (Custodian of Securities) Regulations, 1996:

Regulation 2 (d) : “custodian of securities” means any person who carries on or proposes to carry on the business of providing custodial services;

Regulation 2 (e) : “custodial services” in relation to securities of a client or gold or gold related instruments held by a mutual fund in accordance with the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 means, safe keeping of such securities or gold or gold related instruments and providing services incidental thereto, and includes—

- (i) maintaining accounts of securities or gold or gold related instruments of a client;
- (ii) collecting the benefits or rights accruing to the client in respect of securities or gold or gold related instruments;
- (iii) keeping the client informed of the actions taken or to be taken by the issuer of securities, having a bearing on the benefits or rights accruing to the client; and
- (iv) maintaining and reconciling records of the services referred to in sub-clauses (i) to (iii);