



Report of the
Committee to Review the Framework of Access to Domestic
and Overseas Capital Markets
(Phase II, Part I: Indian Depository Receipts)

Ministry of Finance
Government of India

June, 2014



Report of the
Committee to Review the Framework of Access to Domestic
and Overseas Capital Markets
(Phase II, Part I: Indian Depository Receipts)

Ministry of Finance
Government of India

June, 2014

**COMMITTEE TO REVIEW THE FRAMEWORK OF ACCESS TO DOMESTIC AND
OVERSEAS CAPITAL MARKETS**


New Delhi
June 9, 2014

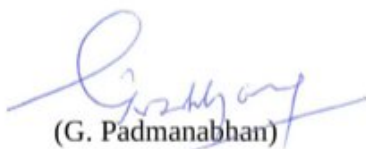
Shri Arun Jaitley
Hon'ble Union Minister for Finance,
Company Affairs and Defence
Government of India
New Delhi – 110 001


Dear Minister,

The Committee to review the framework of access to domestic and overseas capital markets, constituted vide order F. No. 9/1/2013 – ECB dated January 10, 2014, hereby presents its report in respect of domestic depository receipts to the Government of India. The report in respect of other items of reference will be submitted in due course.


Yours sincerely,


(M. S. Sahoo)
Chairman


(G. Padmanabhan)
Member



(S. Ravindran)
Member


(Ajay Shah)
Member

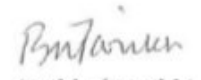

(P.R. Suresh)
Member


(Sunil Gupta)
Member


(Manoj Joshi)
Member


(Somsasekhar Sundaresan)
Member


(Pratik Gupta)
Member


(Bobby Parikh)
Member


(Sanjeev Kaushik)
Member Convener

Contents

Acronyms	i
Acknowledgement	iv
Executive Summary	vi
1 Introduction	3
1.1 Constitution of the Committee	3
1.2 Scope of work	4
1.3 Process followed	4
1.4 Structure of the report	4
2 Background	5
2.1 Aspiration: A globally competitive Indian financial system	5
2.2 Depository receipts and international competitiveness	6
2.3 Overview of depository receipts	7
2.4 Benefits of depository receipts to India	7
2.4.1 Benefits to the Indian financial system	7
2.4.2 Benefits to Indian investors	8
2.4.3 Benefits to issuers and financial service providers	9
2.5 Analysis of selected foreign jurisdictions	10
2.5.1 Overview of data and regulatory approaches	10
2.5.2 US: Broad spectrum of DR variants, accessible trading platform	15

2.5.3	Singapore and South Korea: significant restrictions	16
2.5.4	Brazil: Emerging market with the DR regime modelled on US	18
2.6	Limitations of the extant IDR framework	18
2.6.1	Legislative History	18
2.6.2	Recent developments	19
2.6.3	Need for review	19
3	Guiding principles	27
3.1	Contemporary policy thinking on regulation of markets	27
3.2	Contemporary policy thinking on competitiveness	29
3.2.1	Percy Mistry Report	29
3.2.2	Raghuram Rajan Report	29
3.2.3	Standing Council of Experts	29
3.3	Contemporary policy thinking on investor protection	30
3.3.1	U.K. Sinha Report	30
3.3.2	Justice B.N. Srikrishna Report	30
3.4	Harmonising depository receipts with capital controls	30
4	Issues and Responses	33
4.1	Should issue and trading of DRs be allowed?	33
4.2	What should be the underlying securities for DRs?	34
4.3	What should be the extent of regulations of BhDRs?	36
4.4	How to protect the interests of investors in BhDRs?	36
4.5	Who can provide the underlying for the BhDRs?	39
4.6	For what purposes can BhDRs be issued in India?	40
4.7	Should there be limits on the issue size of BhDRs?	41
4.8	Should BhDRs be listed in India?	42
4.9	Should the pricing of BhDRs be regulated?	42
4.10	What should be the extent of fungibility?	42
4.11	Should holders of BhDRs have voting rights?	43
4.12	Who can be a foreign custodian?	43
4.13	Who may issue BhDRs in India?	44
4.14	Who may invest in BhDRs?	44
4.15	How to deal with conflict in provisions in two jurisdictions?	47
4.16	Should trading of foreign DRs be permitted?	47
4.17	Can SEBI deal with market abuse?	47
4.18	How should the BhDRs be taxed?	49

4.19	Which authority/ law should govern issue/ trading of BhDRs?	52
4.20	Is approval necessary for issue of BhDRs?	53

5 Recommendations 55

5.1	Principles	55
5.2	Recommendations	56
5.3	Bharat Depository Receipts Guidelines	59

Bibliography 61

Articles	61
Reports	62
Laws	63

Annexure-A1: Ministry of Finance order dated September 23, 2013 constituting the Committee 65

Annexure-A2: Ministry of Finance order dated January 01, 2014 constituting the second phase 69

Annexure-A3: Ministry of Finance order dated January 10, 2014 partially modifying earlier order 73

Annexure-A4: Ministry of Finance order dated February 5, 2014 nominating Mr. Sunil Gupta as member 77

Annexure-B: List of stakeholders who engaged with the Committee 79

Annexure-C: The Bharat Depository Receipts Guidelines, 2014 81

Acronyms

ADR	American Depository Receipt.
BDR	Brazilian Depository Receipt.
BhDR	Bharat Depository Receipt.
CCMR	Committee on Capital Markets Regulation.
DDT	Dividend Distribution Tax.
DOJ	US Department of Justice.
DR	Depository Receipt.
ECB	External Commercial Borrowing.
FATF	Financial Action Task Force.
FCCB	Foreign Currency Convertible Bond.
FII	Foreign Institutional Investor.
FSLRC	Financial Sector Legislative Reforms Commission.
GAAP	Generally Accepted Accounting Principles.
GDR	Global Depository Receipt.
ICSI	Institute of Company Secretaries of India.
IDR	Indian Depository Receipt.
IFC	International Financial Centre.
IFRS	International Financial Reporting Standards.
IFS	International Financial Service.
IOSCO	International Organization of Securities Commissions.
IPO	Initial Public Offering.
IRDA	Insurance Regulatory and Development Authority.

KDR	Korean Depository Receipt.
KSD	Korean Securities Depository.
MMoU	Multilateral Memorandum of Understanding.
NIPFP	National Institute of Public Finance and Policy.
NRI	Non-resident Indian.
OTC	Over The Counter.
PMEAC	Economic Advisory Council to the Prime Minister.
QIB	Qualified Institutional Buyer.
RBI	Reserve Bank of India.
SDR	Singapore Depository Receipt.
SEBI	Securities and Exchange Board of India.
SEC	U.S. Securities and Exchange Commission.
SFRS	Singapore Financial Reporting Standards.
STT	Securities Transaction Tax.
UK	United Kingdom.
US	United States of America.

Acknowledgement

The framework governing issue and trading of Indian Depository Receipts (IDRs) in India has its genesis in section 605A, which was inserted into the *Companies Act, 1956* by the *Companies (Amendment) Act, 2000*. To operationalise the framework, the Government issued the *IDR Rules, 2004* and the Securities and Exchange Board of India (SEBI) inserted Chapter VIA to the *SEBI (Disclosure and Investor Protection) Guidelines, 2000*. On the repeal of the *SEBI (Disclosure and Investor Protection) Guidelines, 2000*, the aforesaid Chapter VIA was transplanted as Chapter X in the *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*. However, except for the issue by Standard Chartered PLC in 2009, there has been no other issue of IDRs.

Meanwhile, the *Companies Act, 1956* has given way to the *Companies Act, 2013*. Government has notified the *Companies (Registration of Foreign Companies) Rules, 2014*. The domestic financial markets have undergone substantial structural transformation over the last decade. India's policy stance towards the economy, capital flows, and laws and regulations relating to financial markets has become more modern and contemporary. This Committee has recently recommended an American Depository Receipt (ADR)/Global Depository Receipt (GDR) scheme which has been accepted by the Government on May 13, 2014. These developments warrant a fresh look at the framework supporting the IDR regime. The Committee thanks the Ministry of Finance, Department of Economic Affairs, for providing an opportunity for doing so.

I am grateful to each member of the Committee for putting in long hours of work and making significant contributions to the deliberations and drafting of this report:

1. Mr. G. Padmanabhan, Executive Director, Reserve Bank of India (RBI);
2. Mr. S. Ravindran, Executive Director, SEBI;
3. Dr. Ajay Shah, Professor, National Institute of Public Finance and Policy (NIPFP);
4. Mr. P. R. Suresh, Consultant, Economic Advisory Council to the Prime Minister (PMEAC);
5. Mr. Sunil Gupta, Joint Secretary, Department of Revenue, Ministry of Finance;
6. Mr. Manoj Joshi, Joint Secretary, Department of Economic Affairs, Ministry of Finance;

7. Mr. Somasekhar Sundaresan, Partner, JSA;
8. Mr. Pratik Gupta, Managing Director, Deutsche Bank;
9. Mr. Bobby Parikh, Partner, BMR & Associates; and
10. Mr. Sanjeev Kaushik, Director, Ministry of Finance.

I am extremely grateful to Dr. Ila Patnaik, Principal Economic Adviser, Ministry of Finance (then Professor, NIPFP) for supporting the Committee as a special invitee in terms of research analysis and thought leadership.

I am thankful to Mr. Rabindra Kumar Das of Adani Group, Mr. Juvenil Jani of Adani Mining Private Ltd., Mr. Sanjay Agarwal of Bank of America, Mr. Abhishek Garg and Ms. Kaku Nakhate of Bank of America Merrill Lynch, Mr. Abhishek Agarwal of Citibank, Ms. Bhavna Thakur and Mr. Jeetendra Parmani of Citigroup Global Markets India Private Ltd., Mr. Akalpiti Gupte of Deutsche Bank, Mr. Jitendra Jain and Mr. Kamalakara Rao Yechuri of GMR Group, Mr. Maneesh Malhotra of HSBC, Mr. Nehal Vora and Mr. Archit Lohia of Bombay Stock Exchange, Mr. Hari K. of National Stock Exchange, Mr. L. S. Narayanswami and Ms. Kanchan Bhawe of Standard Chartered, Mr. Manu J. Vettickan of the Ministry of Finance, Mr. R. N. Kar of RBI, Mr. V. S. Sundaresan, Mr. Anjan Patel, Mr. Pranav Variava of SEBI, and Ms. Neena Prasad of SGX, for engaging with the Committee and sharing their experiences, concerns and perspectives.

The Secretariat for the Committee, the NIPFP Macro/Finance Group, delivered outstanding research support as it has been doing for numerous other government projects. Mr. Pratik Datta, the leader of this team put in tireless efforts and brought in significant insights into the issues and prepared the first draft of the report. Mr. Arjun Rajagopal, Mr. Shubho Roy, Mrs. Radhika Pandey, Mr. Shekhar Harikumar, Mr. Pramod Sinha, Mr. Vikram Bahure, Mr. Kushagra Priyadarshi and Ms. Sanhita Sapatnekar of the team brought on the table their perspectives on the complex issues for consideration of the Committee. Mrs. Neena Jacob of NIPFP managed the process smoothly and flawlessly.

I acknowledge the support from SEBI and NIPFP for making their facilities available to the Committee for holding extensive meetings and extending warm hospitality.

June 9, 2014

M. S. Sahoo

Executive Summary

The international competitiveness of the Indian financial system is important from two perspectives. The first is the interests of domestic users of finance. Households and firms in India deserve access to world class financial services; they must not be hostage to the infirmities, if any, of the Indian financial system. Indian users being able to access the best financial choices motivates the provision for access to international markets through issuance of ADRs/GDRs for Indian firms and provision for access to foreign securities through issuance of domestic depository receipts like IDRs for Indian households. The second is rooted in the possibilities of export of financial services from India. When a global company issues IDRs in India, the entire financial services revenue stream in primary and secondary market activities accrues to India. India is already an important producer of financial services for the global financial system through operations of global firms in India. This must evolve into a full-fledged international financial centre which attracts users from the world over.

India uses capital controls as part of its macroeconomic tool-kit to regulate capital flows. Hence the approach is to rationalise and harmonise the framework relating to the issue and trading of Depository Receipts (DRs) with the broader overarching capital controls regime. Therefore, the strategy for policy should emphasize *removing impediments* against and making clear provisions for issue and trading of DRs in India. This by itself may not ensure a vibrant market for DRs in India. The most that can be achieved through reforms in the market for DRs is to create a competitive environment. After this, the outcome actually obtained will depend on the attractiveness of the Indian primary market and secondary market and maturity of investors. If regulations, infrastructure, financial firms and investors are capable, then India will attract issuance and trading of DRs. This Committee does not believe that the government should subsidise or support DRs in India in any way other than removing impediments and providing clarity, so that there is a level playing field between producing for the Indian market (i.e. securities issuance by an Indian firm) and the export market (i.e. securities issuance by a non-resident).

Pulling together the ADR/GDR reforms and domestic DR reforms, the Committee

envisages a more competitive landscape for the Indian primary and secondary market. Indian issuers will evaluate whether the ADR/GDR market better serves their interests and global firms will evaluate whether domestic DR issues make sense. This will bring competitive pressure upon the Indian primary and secondary market. This competition will encourage reforms of regulations, drive modernisation by infrastructure institutions and financial firms, and result in improved efficiency of the Indian economy. This is the standard logic of harnessing the dynamic gains of trade liberalisation.

A vibrant domestic DR market would have one additional positive impact upon the Indian economy, through reduction of risk. At present, household portfolios, and the positions of financial firms, suffer from poor diversification by an over-emphasis on Indian assets. This home bias is likely to decline when global assets are made more visible and more accessible through the domestic DR market. Through this mechanism, the creation of a vibrant domestic DR market would cater to the goal of risk reduction in finance and improve the welfare of households.

What must the regulatory strategy for domestic DRs be? When securities issuance takes place, the only potential market failure is consumer protection. The strategy which has been adopted worldwide and which is recommended by the Committee here, consists of having multiple mechanisms through which the issuer chooses to face greater regulation in return for greater access to the Indian market.

The simplest design involves two levels of domestic DRs. One level would give access to all Indian investors – and require compliance with regulations faced by an Indian issuer of securities that are accessible to all Indian investors. Another level would have a lower regulatory burden – but only give access to sophisticated investors by having Rs.1 million market lot. That is, the smallest unit in which the securities could be issued and traded should be Rs.1 million, which would keep out unsophisticated investors.

From the viewpoint of India's role in international finance, and the aspiration that an international financial centre should emerge, foreign investors should be fully free to participate in the domestic DR market. The laws and regulations relating to markets and Indian institutional investors must be modified to ensure that there is a level playing field between an Indian security and a domestic DR in the eyes of all Indian institutional investors and they must be allowed, enabled and encouraged to reduce their portfolio risk through international diversification including investments in IDRs.

Some of the restrictions on IDRs that exist today are not motivated by the objective of addressing market failures, lack a rationale and need to be removed. IDRs require tax clarity and parity for both domestic and foreign investors. With domestic investors, this means that investing in a domestic DR should be like investing in a comparable domestic security. With foreign investors, this means that investing in a domestic DR should be comparable with the same security elsewhere in the world.

1 — Introduction

1.1 Constitution of the Committee

The Ministry of Finance constituted a Committee, vide its Office Order dated September 23, 2013 (Annexure-A1), to comprehensively review the Foreign Currency Convertible Bonds and Ordinary Shares (Through Deposit Receipt Mechanism) Scheme, 1993. Accordingly, the Committee submitted its report along with the draft of the proposed Depository Receipts Scheme in replacement of the extant scheme, to the Ministry of Finance on November 26, 2013. Subsequently, vide Office Orders dated January 1, 2014 (Annexure-A2), January 10, 2014 (Annexure-A3) and February 5, 2014 (Annexure-A4), the Ministry of Finance reconstituted the Committee as under:

1. Mr. M. S. Sahoo, Secretary, Institute of Company Secretaries of India (ICSI);
2. Mr. G. Padmanabhan, Executive Director, RBI;
3. Mr. S. Ravindran, Executive Director, SEBI;
4. Dr. Ajay Shah, Professor, NIPFP;
5. Mr. P. R. Suresh, Consultant, PMEAC;
6. Mr. Sunil Gupta, Joint Secretary, Department of Revenue, Ministry of Finance;
7. Mr. Manoj Joshi, Joint Secretary, Department of Economic Affairs, Ministry of Finance;
8. Mr. Somasekhar Sundaresan, Partner, JSA;
9. Mr. Pratik Gupta, Managing Director, Deutsche Bank;
10. Mr. Bobby Parikh, Partner, BMR & Associates;
11. Mr. Sanjeev Kaushik, Director, Ministry of Finance.

These orders mandate the Committee to review the entire framework of access to domestic and overseas capital markets and related aspects. These include the frameworks relating to:

- Indian depository receipts (IDRs);
- External Commercial Borrowing (ECB) and Foreign Currency Convertible Bonds (FCCBs);
- Direct listing of Indian companies abroad;
- Dual listing of Indian companies;

- Residence-based taxation vis-a-vis source based taxation in respect of such instruments; and
- Relationship between authorities in India and those in foreign jurisdictions.

1.2 Scope of work

Given the wide ranging terms of reference, the Committee decided to take up these terms in phases. It decided, to start with, to undertake a review of the framework governing issue and trading of DRs in India. While deliberating on the matter it became obvious that there is tremendous potential to allow DRs much beyond IDRs as defined in the *Companies Act, 2013*. For the sake of convenience, the Committee prefers to call these instruments as Bharat Depository Receipts (BhDRs), which include IDRs. This part of the report reviews the framework governing IDRs and recommends a new framework governing Bharat Depository Receipts (BhDRs).

1.3 Process followed

The Committee had three meetings devoted to deliberations on DRs in India. During these meetings it consulted the stakeholders concerned, and delineated the relevant policy issues and deliberated extensively on the same. The deliberations of the Committee were informed by the research conducted by its secretariat, the NIPFP Macro/Finance Group. The research was based on relevant data collected by the NIPFP Macro/Finance Group from various sources, including some of the stakeholders, and contemporary thought as reflected in recent policy decisions and committee reports. The list of stakeholders who engaged with the Committee is at Annexure-B.

1.4 Structure of the report

The report is structured as follows: Chapter 2 provides the background against which the Committee studied the current legal and institutional framework for IDRs. It discusses the importance, as highlighted by previous expert committees, of developing an internationally competitive financial services sector in India. It explains how the creation and performance of domestic DRs can act as a critical parameter to measure the international competitiveness of the Indian financial sector. This is supported by an analysis of selected foreign jurisdictions, namely, United States of America (US), Singapore, South Korea and Brazil. Against this international backdrop, the shortcomings of the extant Indian framework governing IDRs is explained. The Chapter concludes by highlighting specific areas that require review. Chapter 3 provides the guiding principles that informed the Committee in this review process. It looks at contemporary policy thinking on regulating financial markets, competitiveness and investor protection in finance. It also highlights the need to streamline the capital controls regime and align it with the needs of the domestic DR market. Based on these principles, Chapter 4 identifies the primary policy issues relevant to the review and frames each issue as a question. The Committee's corresponding recommendations are stated in the form of answers, accompanied by explanations. Chapter 5 summarises the recommendations of the Committee to modify the legal and institutional framework for domestic DRs.

2 — Background

2.1 Aspiration: A globally competitive Indian financial system

The 2007 report of the High Powered Expert Committee on Making Mumbai an International Financial Centre (popularly known as the *Percy Mistry Report*) argued that Mumbai is well-positioned to attain the status of an International Financial Centre (IFC) because of a number of natural advantages that can be complemented by forward thinking policy reforms.¹ It envisaged creating a world class financial system in India which would be internationally competitive in four broad areas:²

A well-developed, sophisticated, open financial system characterised by: (i) a complete array of proficient, liquid markets in all segments, i.e. equities, bonds, commodities, currencies and derivatives; (ii) extensive participation by financial firms from around the world, (iii) full integration of market segments, i.e. an absence of artificially compartmentalised, isolated financial markets that are barred from having operational linkages with one another; and (iv) absence of protectionist barriers and discriminatory policies favouring domestic over foreign financial firms in providing financial services...

For an IFC to emerge, it has to be internationally competitive. This is important for India from two points of view. First, finance can be a high value-added export sector, much like information technology has become a high value-added export success story for India. Second, the *domestic* economy can be well served by a world class financial system when overseas users, who have the *choice* of going elsewhere, become customers of the Indian financial system.

These arguments are the same as those that drove India's opening up to international trade in manufacturing. As an example, an internationally competitive steel industry

¹ See, Percy Mistry, *Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre*, tech. rep., Feb. 10, 2007.

² See, *ibid.*, p. xiv.

is good for India as it generates export revenues. When overseas users, who have the choice of going elsewhere, choose to become customers of Indian steel companies, it is a sign that the domestic economy is being well served by a world class steel industry. Given that many elements of finance are tradable, the logic of trade liberalisation and the consequential dynamic gains from global competition also apply to finance.

In the United States of America (US), the Committee on Capital Markets Regulation (CCMR), an independent research organisation whose members include leaders from finance, law and academia, uses several measures for tracking the global competitiveness of the US capital markets.³ The measures include cross-listings of foreign companies in the US, the share of top twenty global Initial Public Offerings (IPOs) by foreign companies conducted in the US, the US share in global market capitalisation and the US share of trading in securities that can be traded either on an US or foreign exchange.⁴ The presence of foreign issuers, who *choose* to use the local financial system, is necessary to realise the global competitiveness of the local financial system.

2.2 Depository receipts and international competitiveness

Firms seek the lowest possible cost of capital for financing projects. Financial markets connect capital from investors to the most productive applications in firms. Therefore, fund raising is a key function of financial markets.⁵ A number of the CCMR measures are concerned with the attractiveness of the US capital markets to foreign firms, who can choose from among multiple jurisdictions:⁶

The US share of Global IPOs by foreign companies reflects the relative attractiveness of US public markets to foreign companies. The measure is especially telling because foreign companies – more so than US companies—must *choose* to come to the US.

According to the *Percy Mistry Report* and the CCMR research, trading in cross-listed securities is integral to an internationally competitive IFC.⁷ The *Percy Mistry Report* includes such trading as one of the services provided by IFCs:⁸

Global/Regional Exchange Trading of Financial Securities, Commodities and Derivatives Contracts in Financial Instruments/Indices and in Commodities: There is an increasing tendency toward multiple listings of financial securities (equities and debt), and of derivative and commodity contracts, on different exchanges with emerging investor demand for 24 x 7 x 365 trading of all listed securities across all exchanges. Demand is highest for the securities of index-corporations in each major capital market. It will

³See, Committee on Capital Markets Regulation, *Competitiveness Measures*, tech. rep., Committee on Capital Markets Regulation, Dec. 31, 2012, URL: <http://capmktreg.org/education-research/competitiveness-measures/> (visited on 02/02/2014).

⁴See, *ibid.*

⁵See, Percy Mistry, see n. 1, p. xvi.

⁶See, Committee on Capital Markets Regulation, *Competitiveness Measures*, see n. 3, “Measure 2 - Global IPOs by Foreign Companies”.

⁷See, *ibid.*

⁸See p. xvii, Percy Mistry, see n. 1.

gradually cascade downwards to cover global trading of all listed securities in all markets – developed and emerging.

The competitiveness of the US capital market in this dimension is captured by CCMR through the ‘US share of trading in securities that can be traded either on a US or foreign exchange’. In the context of the US markets, this measure captures the ratio of the volume of trading in ADRs to the volume of trading in the underlying securities within the issuer’s home jurisdiction.

2.3 Overview of depository receipts

DRs constitute an important mechanism through which issuers can raise funds outside their home jurisdiction. Securities issued by a firm are deposited with a domestic custodian in the firm’s domestic jurisdiction, and a corresponding ‘depository receipt’ is issued abroad, which can be purchased by foreign investors. DRs can be listed on an exchange or traded in an Over The Counter (OTC) market.

As discussed in the *Sahoo Report (Phase I)*, DRs provide a number of strategic, reputational and risk-mitigation benefits to issuers and investors, in addition to being a mechanism for raising capital.⁹

DRs are generally classified as under:

- **Sponsored**, in which the issuer enters into a formal agreement with the foreign depository to create or issue DRs. A sponsored DR issue can be classified as:
 - **Capital Raising**, in which the issuer deposits its own freshly issued securities with a domestic custodian and the proceeds from the sale of the DRs go to the issuer; and
 - **Non-Capital Raising**, in which the issuer gets holders of its existing securities to deposit these securities with a domestic custodian, and the proceeds from the sale of the DRs go to the holders of the underlying securities.
- **Unsponsored**, in which depository banks organise the issuance of DRs without any involvement of the issuer of the underlying securities.

Based on whether a DR is traded in an organised market or in the OTC market, the DRs can be classified as *listed* or *unlisted* respectively. This distinction is however clouded by the development of ‘organised OTC markets’ in some jurisdictions. Jurisdictions may choose to restrict access to DR markets to Qualified Institutional Buyers (QIBs) or to ‘offshore’ participants, who are foreign entities merely using the jurisdiction’s platform to trade amongst themselves.

2.4 Benefits of depository receipts to India

2.4.1 Benefits to the Indian financial system

A well-functioning DR market is an indicator of a healthy, well-regarded, globally competitive financial system.

As argued in the *Sahoo Report (Phase I)*, allowing Indian firms to list on foreign exchanges will expose the Indian capital markets to global competition.¹⁰ As a result,

⁹See, M.S. Sahoo, *Report of the committee to review the FCCBs and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993*, tech. rep., Ministry of Finance, Nov. 26, 2013.

¹⁰See, *ibid.*

Table 2.1: Portfolio risk: Autarky versus international diversification, 2004-2013

Country	Volatility of stock market index (% per day)
China	1.69
India	1.65
Japan	1.57
Italy	1.55
Jakarta	1.49
France	1.44
South Korea	1.43
Germany	1.38
South Africa	1.28
UK	1.21
US	1.19
Australia	1.12
Equally Weighted Average	0.93

Sources: <http://markets.wsj.com>. and Prowess

the entire Indian financial market system will come under competitive pressure. This will nudge the functioning of private firms as well as the regulators. Rational rules supported by efficient enforcement will encourage the growth of a competitive financial system in India.¹¹ Indian exchanges and financial intermediaries will be under greater pressure to develop and maintain world-class platforms, where transaction costs are low, and rules are predictable and enforceable. This will attract and benefit investors and issuers, both domestic and foreign, who seek to conduct business with clarity and confidence, and will minimise opportunities for regulatory arbitrage.¹²

2.4.2 Benefits to Indian investors

The fundamental benefit of a well-functioning DR market in India is that it would provide Indian investors with access to a wider range of securities for investment. This will enable an Indian investor to diversify her portfolio globally. International diversification ensures less exposure to volatility compared to investing in a local security, such as NIFTY. Table 2.1 shows that for the period 2004 to 2013, the standard deviation of the daily returns on NIFTY is 1.65% while that for an internationally diversified portfolio is only 0.93%. This shows the sharp gains in terms of reduced risk for Indian households and institutional investors in moving from autarky (investing in India only) to global diversification.

A difficulty in household and institutional portfolio choice that is prevalent all over the world is *home bias*: investors tend to overweigh the home country in their portfolio; they tend to over-invest in domestic securities and under-invest in international securities. Easy exposure to international securities through the DR route, will help improve the quality of portfolios constructed in India:¹³

1. *Increasing convenience*: DRs in India trade and settle in the same manner as any other security in India. The investors pay the same commission rates, and dividends on the domestic DRs are paid in rupees. In addition, it is easier for an Indian investor to place orders during regular trading hours in India, as opposed to having to place orders according to the business hours of a jurisdiction in another

¹¹See p. 14, M.S. Sahoo, see n. 9.

¹²See generally, Percy Mistry, see n. 1.

¹³See p. 9, M.S. Sahoo, see n. 9.

time zone;

2. *Reducing pooling custody fees and foreign exchange costs*: Individual investors may face high custody and foreign exchange conversion fees for directly holding securities in a foreign jurisdiction. By pooling together a number of investors, the DR issuer can obtain whole-sale rates. This may reduce the transaction fees that a DR holder pays; and
3. *Enhancing legal responsibility*: An investor in India may feel more comfortable relying on the legal protections available under Indian law in India. Depending on the home jurisdiction of the DR issuer, these protections may be more accessible and effective than protections available abroad.

The DR route is attractive to investors because it offers a combination of simplicity, protection and flexibility, as compared to investing directly in a foreign market.

2.4.3 Benefits to issuers and financial service providers

Issuers make use of capital markets outside their home jurisdiction, for various reasons. As detailed in the *Sahoo Report (Phase I)*, these include:¹⁴

1. *Capital raising*: Even firms in advanced economies, with developed financial markets and no capital controls, avail of the DR mechanism to access the capital markets abroad. Table 2.2 shows the number of outstanding DR programmes originating from some of the advanced economies.

Table 2.2: Outstanding DR program originating from select advanced economies

Country	ADR	GDR	Others	Total
United Kingdom	391	27	0	418
Japan	340	1	1	342
Australia	298	8	0	306
Hong Kong	248	4	0	252
Germany	119	1	2	122

Source: JP Morgan

2. *Improved liquidity*: Cross-listing broadens and diversifies the pool of investors who are able to access the securities.
3. *Valuation*: By submitting to higher disclosure standards in another jurisdiction, the company signals that it is of a higher quality than its domestic peers who have not listed abroad. This may improve the value of the company.
4. *Shareholder protection*: Listing in a jurisdiction with higher standards of corporate governance and minority shareholder protection signals the commitment of the company to protect interests of minority shareholders.
5. *Bonding*: By listing in a jurisdiction where it is more difficult to capture private benefits of corporate control, promoters and managers signal that they have 'bonded' themselves with the long term interests of the shareholders.¹⁵

¹⁴For further literature on this, see, G. Andrew Karolyi, "Why do Companies List Shares Abroad?: A Survey of the Evidence and Its Managerial Implications", in: *Financial Markets, Institutions and Instruments* 7 (1998); Abed Al-Nasser Abdallah and Christos Ioannidis, "Why do firms cross-list? International evidence from the US market", in: *Quarterly Review of Economics and Finance* 5 (2010), pp. 202–213; Evangelos Benos and Michael S. Weisbach, "Private benefits and cross-listings in the United States", in: *Emerging Markets Review* 5 (2004), pp. 217–240.

¹⁵See generally, John C. Coffee Jr., "Racing Towards the Top: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance", in: *Columbia Law Review* 102 (2002).

6. *Visibility*: Trading on international capital markets provides greater visibility and has a potential positive effect on the sales of the company's products.
7. *Analysts' opinion*: Some jurisdictions may not have specialised analysts for the industry in which the firm operates. Some firms may benefit from exposure to a larger pool of specialised analysts operating in the international market.

Many of these reasons seem most obvious in the context of firms seeking to access deep, liquid capital markets in advanced jurisdictions such as the US. However, as the Indian financial system develops its strategic and competitive advantages in the region and globally, these reasons will apply more forcefully to issuers who are considering listing IDRs in India.

The benefits to traders and those who provide integrated financial services are clear. As highlighted in the *Percy Mistry Report*, increasing the volume and variety of products that can be offered in India, will create an environment in which service providers will thrive.¹⁶ Managing issuance, and trading of products such as DRs, are crucial for deepening India's high-end financial skills base, and creating room for an expanded market for integrated financial services.

2.5 Analysis of selected foreign jurisdictions

2.5.1 Overview of data and regulatory approaches

An overview of jurisdictions where DRs are issued or traded, suggests that there are several regulatory approaches to DRs, which impact design choices:

- Permit issuance of a broad spectrum of domestic DR variants, or restrict DR issuance to exchange-traded, capital-raising exercises;
- Allow foreign DRs to be traded on domestic platforms, or allow only locally issued DRs to be traded on these platforms;
- Allow issuers to have access to the domestic retail investor base or allow only certain kinds of investors to purchase and trade DRs; and
- Open up activities in the issuance and trading process to market participation, or carry them out through centrally controlled institutions: for example, Korean Securities Depository (KSD) functions as a nationalised depository institution for issuance of DRs in Korea, while other countries permit market players to fulfil this role.

The following sections describe how these design choices have been combined in particular jurisdictions. A comparative picture of design of select DR markets is presented in Table 2.3.

¹⁶See, Percy Mistry, see n. 1.

Table 2.3: Market design of select economies

Parameter	India	Brazil	USA (NYSE)	USA (NASDAQ)	Singapore	Korea (KOSDAQ)	Korea (KOSPI)
<i>Paid up Capital</i>	At least \$50Mn	None, but must be a publicly held company, admitted to trading in a permitted jurisdiction	None	Standard 1: Shareholder's equity of at least \$15Mn Standard 2: Shareholder's equity of at least \$30Mn	None	Equity capital of at least KRW 3Bn	Equity capital of at least KRW 3Bn
<i>Market Capitalization</i>	At least \$100Mn during last three years	None	At least \$100Mn market value of publicly held shares worldwide. Standard 2: (a) At least \$500Mn global market capitalization; or (b) At least \$750Mn global market capitalization	Standard 1: \$8Mn market value of publicly held shares; Standard 2: \$18Mn market value of publicly held shares; Standard 3: \$75Mn market cap or \$75Mn each in total assets and total revenue for most recently completed fiscal year or two of the last three most recently completed years; \$20Mn market value of publicly held shares	Standard 2: At least S\$150Mn Standard 3: At least S\$300Mn	Base market cap at least KRW 9Bn Standard 3: At least KRW 30Bn	Standard 2: At least KRW 400Bn
<i>Financial Reporting Compliance</i>	Indian GAAP, IFRS or US GAAP	Un-sponsored, Level 1: No need to comply with Brazilian requirements; Levels 2 and 3: Either a) Brazilian standards or IASB standards or home country standards if firm is from Mercosur country	Un-sponsored, Level 1: Home country standards; Levels 2 and 3: Audited statements in accordance with US GAAP or reconciled from home-country GAAP or IFRS to US GAAP	Un-sponsored, Level 1: Home country standards; Level 2 and 3: Audited statements in accordance with US GAAP or reconciled from home-country GAAP or IFRS to US GAAP	US GAAP, IFRS or SFRS	IFRS, Korean GAAP, or US GAAP	IFRS, Korean GAAP, or US GAAP

Table 2.3: Market design of select economies

Parameter	India	Brazil	USA (NYSE)	USA (NASDAQ)	Singapore	Korea (KOSDAQ)	Korea (KOSPI)
<i>Profitability</i>	Distributable profits in three out of preceding five years	None, but if new company must file feasibility study with CVM	Standard 1: \$100Mn pre-tax income for last 3 years, at least US \$25Mn in each of 2 most recent years; Standard 2: (a) At least \$100Mn revenue during most recent 12 month period, at least \$100Mn aggregate cash flows for last 3 years, with minimum \$25Mn in most recent 2 years; or (b) At least \$75Mn revenues during most recent year	Standard 1: At least \$1mn annual pre-tax income from continuing operations in the most recently completed year or in two of the last three most recently completed fiscal years	Standard 1: Pre-tax profit of S\$30M for latest year; Standard 2: Profitable with three years of operating track record; Standard 3: Positive operating revenue	Positive income from ongoing business (Not applicable to Large-sized company) Standard 1: Return on equity of at least 10%; Standard 2: Net Income of at least KRW 2Bn; Standard 3: Sales amount of at least KRW 10Bn; Standard 4: Sales Growth of at least 20%, sales amount of at least KRW 5Bn	Standard 1: Sales of at least KRW 100Bn in latest year, KRW 70Bn average of last three years; net income of at least KRW 3Bn in latest year, KRW 6Bn total of last three years; return on equity at least 5% in latest year; 10% total in last three years; Standard 2: Sales amount at least KRW 200Bn in latest year
<i>Operating History</i>	At least three years continuous trading in parent country	None. Should be publicly held in countries with regulatory bodies in a MOU with CVM, and if no history must file feasibility study with CVM	None	Standard 2: Two years operating history	Pre-existing listing in home country not required, but if not already listed at home, must list concurrently	At least three years	At least three years
<i>Financial Reporting Frequency</i>	Annual audited results, or un-audited quarterly reports	Un-sponsored, Level 1: Home country standards; Levels 2 and 3: Must follow Brazilian standards	Un-sponsored, Level 1: Home country requirements; Levels 2 and 3: Annual Reporting	Un-sponsored and sponsored, Level 1: Home country requirements; Sponsored Levels 2 and 3: Annual Reporting	Home country requirements in case of companies listed in home country, Exempt from exchange requirements if follow concurrent disclosure norms	Quarterly reporting	Quarterly reporting

Table 2.3: Market design of select economies

Parameter	India	Brazil	USA (NYSE)	USA (NASDAQ)	Singapore	Korea (KOSDAQ)	Korea (KOSPI)
Cost	Rs. 20,000 Initial listing fees + Annual fees starting from Rs. 1,00,000 (Increases with increase in listed capital)	Listing Annuity = R\$35,000.00 + [(stock capital – 50,000,000) x 0.00473%], an auction cost to the depository bank typically upwards of R\$1,000,000, a registration fees of R\$51,000	Initial listing fee: \$50,000+ \$0.0032 per ADR Annual Listing fee: \$930/Mn ADRs	Initial listing fee: \$125,000 to \$225,000 Annual fee for ADR: From \$30,000 to \$50,000	Initial Listing Fee: From S\$100,000 to S\$200,000 Additional Listing Fee: From S\$30,000 to S\$100,000 Annual Listing Fee: From S\$35,000 to S\$150,000 Non-refundable Processing Fee: S\$20,000 for each application	Initial listing fees: From KRW 50,000 to 46,650,000 (+0.0005% of over KRW 1Tn listed capital stocks) annual dues range from KRW 5,500 to 9,195,000 (+ 250 x capital – 1 Trillion)/100Mn) per KRW 100Mn in listed capital stocks KRW 5,000,000 fee for listing eligibility review.	Initial listing fees from KRW 1,200,000 to 41,800,000 (+0.001% of over KRW 1Tn listed capital stocks) annual dues from KRW 11,000 to 18,390,000 (+ 500 x capital – 1Trillion)/100Mn) per KRW 100Mn in listed capital stocks KRW 5,000,000 fee for listing eligibility review.
Sponsored/Un-sponsored Investor Restrictions	Sponsored only Minimum application amount of Rs.20,000 for retail investors and Rs.1,00,000 for QIB and non-institutional buyers	Sponsored and Un-sponsored Level 1, whether sponsored or unsponsored, is accessible only to sophisticated investors/FIIs For unsponsored, allowed to eligible investors No restrictions for Levels 2 and 3	Sponsored and Un-sponsored None	Sponsored and Un-sponsored None	Sponsored Retail and institutional investors allowed to invest.	Sponsored Shares held by substantial shareholders should be locked-up for one year from listing date	Sponsored Shares held by substantial shareholders should be locked-up for six months from listing date

Table 2.3: Market design of select economies

Parameter	India	Brazil	USA (NYSE)	USA (NASDAQ)	Singapore	Korea (KOSDAQ)	Korea (KOSPI)
<i>Investor Spread</i>	At least 50% of issue allotted to QIBs, 30% to retail investors, including employees, and 20% divided between non-institutional investors and employees at the company's discretion.	None for Levels 1 and 2 Level 3 is subject to CVM Instruction 13/1980 and other norms for public distribution of shares	5000 worldwide investors each holding at least 100 shares, 2.5 mn shares held worldwide	At least 400 round lot holders, 1.1 mn shares held worldwide	Less than S\$300Mn Market Cap: 25% of share capital with investors (500 investors) Market Cap of S\$300Mn or more but less than S\$400Mn: 20% of share capital with investors (500 investors) Market cap of S\$400Mn or more but less than S\$1Bn: 15% of share capital with investors (500 investors) Market Cap of S\$1Bn or more: 12% share capital with investors (500 investors)	Number of minority shareholders at least 500, at least 25% of shares held by minority shareholders, at least 5% of shares to be publicly offered after submission of application for listing eligibility review or Equity capital at least KRW 50Bn, number of minority shareholders at least 500, at least 10% of shares to be publicly offered after submission of application for listing eligibility review or to be publicly offered, number of minority shareholders at least 500	At least 1,000 public shareholders. Fulfil one of the following shares requirements: At least 25% of shares or 5 mn shares held by public shareholders or at least 25% of shares or 5Mn shares to be publicly offered or at least 10% of shares to be publicly offered after submission of application for listing eligibility review.

Sources: Citi, Securities and Exchange Commission (USA), BM&F BOVESPA (Brazil), SGX (Singapore), Korea Exchange (Korea)

2.5.2 US: Broad spectrum of DR variants, accessible trading platform

The first DR was issued in the US in 1927 for the United Kingdom (UK) retailer Selfridges Provincial Stores Limited. Since then, the US has allowed a large market for ADRs to grow. This market grew significantly in the second half of the last century, encompassing ADRs issued on the back of equity shares, non-US government debt, corporate debt, and other instruments.¹⁷ The annual volume of registered non-US debt and equity offerings climbed from \$34.6 billion in 1992 to \$267 billion in 2001, but has fallen since.¹⁸ There have been 180 cross-listings of non-US companies in the US during the period 2000-2012.¹⁹ The US share of trading in securities that can be traded either on a US or a foreign exchange has fluctuated between 9% and 28%.²⁰ Though there are concerns that the US capital market is relatively less attractive than it was some years ago, the data indicate that the US continues to be a hub for issuance and trading activity based on securities of non-US entities.

The development of this market appears to have been assisted by a generally permissive regulatory environment and an absence of capital controls, combined with appropriate enforcement mechanisms. The striking array of products available in the DR route is regulated under a system of 'levels' which clearly define the degree of access to US capital markets:

- *Level 1*: These programs establish a trading presence in the US but cannot be used for capital raising. They may only be traded on OTC markets, and can be unsponsored.
- *Level 2*: These programs establish a trading presence on a national securities exchange in the US but cannot be used for raising capital.
- *Level 3*: These programs can not only establish a trading presence on a national securities exchange in the US but also help raise capital for the foreign issuer. This access comes with regulatory burdens that are intended to offer protections to US retail investors, that are identical to the protections available with regard to securities of domestic listed firms.

The US has also created two regulatory categories for certain defined classes of buyers and traders:

- *Rule 144A*: This involves sale of securities by a non-US issuer only to QIBs in the US.²¹
- *Regulation S*: This involves sale of securities to non-US entities only.

¹⁷See n. 8, p. 51, Mark Saunders, "American Depositary Receipts: An Introduction to U.S. Capital Markets for Foreign Companies", in: *Fordham International Law Journal* 17 (1 1993).

¹⁸See, Kenneth B. Davis Jr., "The SEC and Foreign Companies - A Balance of Competing Interests", in: *University of Pittsburgh Law Review* 71.3 (2009), citing data reported by the SEC and aggregated by the CCMR..

¹⁹See, Committee on Capital Markets Regulation, *Measure 8 - Cross-Listings in the U.S. by Foreign Companies*, Dec. 31, 2012, URL: http://capmktreg.org/wp-content/uploads/2013/02/8-Cross-Listings_by_Foreign_Companies_on_US_Exchanges_12_4_WEB.pdf (visited on 02/04/2014).

²⁰See, Committee on Capital Markets Regulation, *Measure 12 - U.S. Share of Trading in Securities That Can Be Traded Either on a U.S. or Foreign Exchange*, Dec. 31, 2012, URL: http://capmktreg.org/wp-content/uploads/2013/02/12ADR_Trading_Volumes_in_the_US_12_41.pdf (visited on 02/04/2014).

²¹See, Rule 144A, Securities and Exchange Commission, *General Rules and Regulations, Securities Act of 1933*, 17 CFR 230.114A, 1933.

The US system provides flexibility to issuers, allowing them to scale their engagement with the system up or down, depending on their needs and strategic objectives.

2.5.3 Singapore and South Korea: significant restrictions

Three distinct categories of DRs exist under Singapore regulations.

First, ‘Singapore Depository Receipts’, through which an unlisted foreign company can conduct its primary listing in Singapore. Under the current rules, Singapore Depository Receipts (SDRs) can exist only as a Level 3-type IPO. This means that the firm must go through the same process as a domestic company seeking to make a listed public offering, and must keep the exchange informed whenever there is any change in the law of its place of incorporation which may affect or change shareholders’ rights or obligations over its securities.²² The company must provide financial statements submitted with the listing application, and future periodic financial reports, prepared in accordance with Singapore Financial Reporting Standards (SFRS), International Financial Reporting Standards (IFRS) or US Generally Accepted Accounting Principles (GAAP).²³

Second, ‘Global Depository Receipts’, through which a listed foreign company can conduct its secondary listing in Singapore. Such a listing is subject to the following restrictions:²⁴

- These securities though listed on SGX are not traded on SGX and are not available to retail investors;²⁵
- The securities must be listed on a foreign exchange and subject to the listing rules of that exchange.²⁶ In a secondary listing, the company need not comply with the exchange’s listing rules, provided that all information it releases in its home jurisdiction is released concurrently in English to SGX. SGX must be informed of any issuance of additional securities in a class already listed on the exchange and the decision of the home exchange, and the company must at all times comply with new listing requirements promulgated by SGX.²⁷ Further, the financial statements submitted with the listing application, and future periodic financial reports, need only be reconciled to SFRS, IFRS or US GAAP;²⁸ and
- It is important to note that the listing of GDRs in Singapore is designed as a purely capital-raising exercise.

In addition, for mainboard listing, the company must have at least 500 shareholders worldwide. If the company’s home jurisdiction does not have an agreement with SGX to facilitate movement of shares across jurisdictions, the company must have either 500 shareholders in Singapore or 1000 shareholders worldwide.²⁹

A third category is trading in ADRs on SGX Globalquote. This has been allowed since 2010, and several firms’ ADRs were added in 2011,³⁰ with 20 now listed for

²²See, Monetary Authority of Singapore, *Mainboard Rules*, Sept. 29, 2011, Part XI, 216.

²³See, *ibid.*, Part XI, 220.

²⁴See, *ibid.*, Part XI, 252-253.

²⁵See, *ibid.*, Part XI, 252(2).

²⁶See, *ibid.*, Part XI, 217 and 252(1).

²⁷See, *ibid.*, Part XI, 217.

²⁸See, *ibid.*, Part XI, 220.

²⁹See, *ibid.*, Part XI, 210.

³⁰See, SGX, *News Release - SGX expands GlobalQuote footprint with new ADRs*, Dec. 23, 2011, URL: http://infopub.sgsc.com/FileOpen/12232011_SGX_expands_GlobalQuote_footprint_

trading on the exchange.³¹ Retail investors are allowed to trade these securities, which are fully transferable with the issuer's corresponding ADRs listed in the US.³²

To date, the appetite for primary listing in Singapore via the DR route has been low, and only a handful of companies - many of them Indian - have engaged in capital-raising issuances through the secondary listing mechanism for GDRs.

Like Singapore, South Korea is an advanced jurisdiction with modern financial infrastructure and financial regulation. Korea does not have provisions for 'offshore' trading of DRs, but does permit issuance of Korean Depositary Receipts (KDRs). These are sponsored DRs, that are required to be listed on the Korean exchange and used for capital-raising purposes only. However, as of January 2014, only 2 issuances could be found listed on the Korean Securities Depository website,³³ one for a Chinese synthetic fibre company listed in Singapore,³⁴ and the other for an Australian garment and fashion company owning a Korean subsidiary.³⁵ Of these, neither appears to be actively traded.

An analysis of Korea's rules and procedures regarding issuance of KDRs suggests that, though technically DRs are permitted, there are several barriers to the development of a viable market:³⁶

- Korea permits only sponsored, capital-raising issuances – roughly equivalent to US Level 3 ADRs. It applies a correspondingly high level of consumer protection to these issuances, but leaves no avenue for firms or sophisticated traders to make use of Korea's trading infrastructure, or pursue a gradual approach to building visibility among Korean investors;
- There is no competitive market for depository bank services as the KSD conducts all of the activities related to issuance of KDRs, including issuance, conversion and cancellation, management of beneficial owners and exercise of rights, appointment of a custodian for safekeeping of the underlying securities;³⁷
- There is no competitive market for custodial services. A single institution currently serves as the sole recognised custodian for the underlying shares;³⁸ and
- Investor protection requirements are unique and expensive. Investor protection rights available under the issuing firm's articles of incorporation must be of the same level as those provided under Korean law. If they are not, relevant provisions of Korea's Commercial Code and Korea's Financial Investment Services

with_new_ADRs.ashx?App=Announcement&FileID=78047 (visited on 02/04/2014).

³¹See, SGX, *Search results: ADRs*, Feb. 4, 2014, URL: <http://www.sgx.com/wps/portal/sgxweb/home/marketinfo/securities/adr> (visited on 02/04/2014).

³²See, BNY Mellon, *Singapore Exchange: The Asian Gateway*, A Guide to SGX and Depositary Receipts, Dec. 2013, p. 7; also see, Singapore Exchange, *American Depositary Receipts (ADRs) On SGX GlobalQuote*, 2010, URL: http://www.nasdaqtrader.com/content/newsalerts/2010/eta/SGX_ADRFactsheet.pdf (visited on 05/23/2014).

³³See, Korean Securities Depository, *Securities Information*, Feb. 4, 2014, URL: <http://www.ksd.or.kr/eng/information/stock.home> (visited on 02/04/2014), search results for securities containing the designation 'KDR'.

³⁴China Gaoxian Fibre Fabric Holdings Ltd. ("China Gaoxian"), *Securities Information*, 2009, URL: http://www.chinagaoxian.com/investor_relations.html (visited on 02/04/2014).

³⁵Fast Future Brands Ltd., *History*, 2013, URL: http://www.fastfuturebrands.com/en/sub_01_02.php (visited on 02/04/2014).

³⁶See, Korea Securities Depository, *Guide to Issuance of Korean Depositary Receipts*, 2013.

³⁷See, *ibid.*, p. 21.

³⁸At this point, Citibank N.A., has been appointed as the custodian holding the underlying shares, against which KDRs may be issued by KSDs from time to time. See, *ibid.*, p. 22.

and Capital Markets Act must be incorporated into the issuing firm's articles of incorporation.³⁹

2.5.4 Brazil: Emerging market with the DR regime modelled on US

Brazil is a large emerging market with many structural and institutional similarities to India. It is home to a growing retail investor base and is an economic and financial hub for its region. Like India, Brazil does not have a fully open capital account, however, the capital account restrictions in Brazil consist of simple macroeconomic instruments rather than microeconomic interventions. Brazil has attempted to replicate the US DR regime in some important ways, by providing for differentiated levels and permitting unsponsored issuances. It emphasises disclosure requirements rather than eligibility criteria, except that the underlying securities must be of a publicly held company. Brazil is an important success story, as it has successfully attracted a dozen sponsored Brazilian Depository Receipt (BDR) issuances, and 65 unsponsored issuances.

Because of its existing capital controls and enforcement framework, Brazil has specified the following by statute:⁴⁰

- That depository institutions have responsibilities to both the securities regulator and the central bank, for ensuring compliance in processing and reporting transactions and movements of foreign exchange;
- That an 'intervening bank', authorized by the Central Bank to carry out exchange operations, will be responsible to the Central Bank for verifying compliance by the depository institution; and
- That issuing firms must appoint a valid 'Legal Representative' who will be responsible to the securities regulator for ensuring that the issuing firm's reporting obligations are met.

2.6 Limitations of the extant IDR framework

2.6.1 Legislative History

The framework governing issue and trading of IDRs in India has its genesis in section 605A which was inserted into the *Companies Act, 1956* by the *Companies (Amendment) Act, 2000*. To operationalise the framework, the Government issued *IDR Rules, 2004*.

On April 3, 2006, SEBI inserted Chapter VIA to the *SEBI (Disclosure and Investor Protection) Guidelines, 2000* to govern issue of IDRs. When the *SEBI (Disclosure and Investor Protection) Guidelines, 2000* were replaced by the *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009* on August 26, 2009, this portion was transplanted into Chapter X of the latter with suitable modifications. The *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009* provide for eligibility conditions for the foreign issuer company, minimum subscription, procedure of issue and various other restrictions on the issue of IDRs.⁴¹ Certain other aspects, such as

³⁹See, Korea Securities Depository, see n. 36, p. 28.

⁴⁰See, BOVESPA, *Brazilian Depository Receipts*, tech. rep., BOVESPA, 2001, URL: www.bovespa.com.br/pdf/bdr_i_20122001.pdf (visited on 02/02/2014).

⁴¹The regulations allow only listed foreign companies to issue IDRs. See Regulations 97 and 100, SEBI, *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*, 2009.

fungibility, are dealt with through circulars.⁴²

The RBI inserted Schedule 7 to the *FEMA 20* on issue and sale of IDRs in 2012 with retrospective effect from August 22, 2009. This schedule requires the proceeds of the issue of IDRs to be immediately repatriated outside India by the issuer company.⁴³ Moreover, it prohibits redemption of the IDRs into the underlying securities within 1 year from the date of issue.⁴⁴

At present, the *Companies Act, 2013* and the *Companies (Registration of Foreign Companies) Rules, 2014* govern issue of IDRs in India. Further, the *Companies (Registration of Foreign Companies) Rules, 2014* require issuers of IDRs to comply with the *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009* and directions issued by RBI.⁴⁵

2.6.2 Recent developments

The *Companies Act, 2013* was enacted on August 30, 2013. Many of its provisions, including provisions relating to IDRs, came into force with effect from April 1, 2014.⁴⁶ Section 2(48) of the *Companies Act, 2013* defines an IDR. Section 390 of the *Companies Act, 2013* empowers the Central Government to make rules governing the offer, disclosure requirements, manner of dealing, sale, transfer and transmission of IDRs by a company incorporated or to be incorporated outside India.⁴⁷ Pursuant to this provision, the Ministry of Corporate Affairs issued the *Companies (Registration of Foreign Companies) Rules, 2014* on March 31, 2014. These rules provide the eligibility criteria for the foreign companies that can issue IDRs in India. Section 234 of the *Companies Act, 2013* provides for the possibility of merger between a foreign and an Indian company using IDRs.⁴⁸

2.6.3 Need for review

At present, the Indian legal framework for IDRs comprises:

- Sections 2(48), 234, 390, and 469 of the *Companies Act, 2013*;

⁴²These circulars regulate fungibility. See SEBI, *Redemption of Indian Depository Receipts into underlying equity shares*, CIR/CFD/DIL/10/2012, Aug. 28, 2012, URL: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1346153584231.pdf (visited on 06/01/2014); and SEBI, *Guidelines for Enabling Partial Two-Way Fungibility of Indian Depository Receipts*, CIR/CFD/DIL/6/2013, Mar. 1, 2013, URL: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1362136042656.pdf (visited on 06/01/2014).

⁴³See Entry 1(e), Schedule 7, Reserve Bank of India, *Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000*, Notification No. FEMA 20/2000-RB dated 3rd May 2000, May 17, 2000.

⁴⁴See Entry 2(c), Schedule 7, *ibid*.

⁴⁵See Rule 13(1), Ministry of Corporate Affairs, *Companies (Registration of Foreign Companies) Rules, 2014*, 2014.

⁴⁶See, Ministry of Corporate Affairs, *Notification*, File No. 1/15/2013-CL.V, Mar. 26, 2014.

⁴⁷Taking into consideration the divergence of views between the Ministry of Corporate Affairs and SEBI regarding which authority should have jurisdiction over IDRs, the Standing Committee on Finance (2009-10) felt it essential that both the authorities should hold consultations and come to a conclusion. See, Standing Committee on Finance, *The Companies Bill, 2009: Twenty-first Report*, tech. rep., Lok Sabha, Aug. 31, 2010, paragraph 21.17.

⁴⁸The J.J. Irani Committee recommended that Indian shareholders should be permitted to receive IDRs in lieu of Indian shares especially in listed companies as a mode of cross border mergers. See, Jamshed J. Irani, *Report on Company Law*, tech. rep., Ministry of Company Affairs, 2005, paragraph 22.

- Rule 13 of the *Companies (Registration of Foreign Companies) Rules, 2014*;
- Chapter X of the *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*;
- SEBI circulars dated August 28, 2012 and March 01, 2013.
- Schedule 7 of the *FEMA 20*;
- Part I, Section 4, Para 2 of the *Master Circular on Foreign Investment in India*; and
- The *Income Tax Act, 1961*.

Under the extant framework, there has been only one issue of IDRs till date, that was done in 2010 by Standard Chartered Plc. This lukewarm response to the IDR policy indicates that the governing framework is not in sync with contemporary practices and thinking and, therefore, needs a review to realise the benefits of an active IDR market for Indian investors and the Indian financial system. Pursuant to consultations with stakeholders, the Committee has identified the following deficiencies in the current regime governing the IDR market.

DRs other than IDRs

Section 2(48) of the *Companies Act, 2013* defines an IDR as ‘any instrument in the form of a depository receipt created by a domestic depository in India and authorised by a company incorporated outside India making an issue of such depository receipts’. Rule 13 of the *Companies (Registration of Foreign Companies) Rules, 2014* further narrows the scope of IDRs to those DRs issued on the back of foreign equity shares.⁴⁹ This approach excludes the following types of DRs from the scope of the *Companies Act, 2013*:

- Non-capital raising DRs;
- Unsponsored DRs; and
- DRs issued on the back of foreign securities which are not equity shares.

Though these other types of DRs are not specifically prohibited under any law, there is no legal mechanism to facilitate these instruments as legitimate modes of accessing the Indian capital markets. This unduly curtails the scope and potential of the DR market in India.

Non-capital raising / unsponsored IDRs

Under the current Indian legal framework, IDRs can only be capital raising.⁵⁰ This follows from the provisions in the *Companies Act, 2013*, *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009* and *Master Circular on Foreign Investment in India*.

However, DRs need not necessarily be capital raising. A foreign company may sponsor a DR issue backed by its securities without any fresh issue of securities. Similarly, unsponsored issue of DRs can be done by other entities. These are examples of non-capital DR issues. Both the US and Brazil permit non-capital raising DRs.

As detailed in an earlier report by this Committee, there may be various commercial motives behind a non-capital issue of DRs.⁵¹ These include increasing visibility, im-

⁴⁹See Rules 13(3)(j), 13(6)(a), 13(6)(b) and 13(7)(b), Ministry of Corporate Affairs, *Companies (Registration of Foreign Companies) Rules, 2014*, see n. 45.

⁵⁰See Rules 13(3)(j), 13(6)(a), 13(6)(b), 13(7)(b), *ibid*.

⁵¹See, M.S. Sahoo, see n. 9.

proving valuations and deepening liquidity of the market for the underlying securities. By prohibiting the possibility of issuing non-capital raising IDRs, many potential IDR issuers have been restricted from accessing the IDR route.

Restrictive eligibility criteria

The *Companies (Registration of Foreign Companies) Rules, 2014* and the *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009* lay down the eligibility criteria that a foreign company must satisfy to raise capital through the IDR route. These are as follows:

1. Its pre-issue paid up capital and free reserves are at least \$ 50 million and it has a minimum average market capitalisation of at least \$ 100 million during the last three years in its parent country;⁵²
2. It has a track record of distributable profits for at least three of the immediately preceding five years;⁵³
3. It has been continuously trading on a stock exchange in its parent or home country for at least three immediately preceding years;⁵⁴
4. It is not prohibited from issuing securities by any regulatory body;⁵⁵
5. It has a track record of compliance with securities market regulations in its home country;⁵⁶
6. The issue size shall not be less than Rs.50 crore and minimum application amount shall be Rs. 20,000;⁵⁷ and
7. At least 50% of IDRs issued shall be allotted to qualified institutional investors on proportionate basis.⁵⁸

These criteria allow only those foreign companies which meet the eligibility requirements to use the IDR route. This approach is contrary to the approach taken by policy makers in other jurisdictions, including the US and Brazil, and also contemporary thinking about the rationale behind state intervention. The US and Brazil provide for DR regimes based on multiple levels with varying eligibility and disclosure requirements. Therefore, a broader set of companies can access the ADR route in the US and the BDR route in Brazil through different levels of DRs. In this context, one of the major drawbacks of the IDR framework is the present set of eligibility conditions which is based on a 'one-size-fits-all' approach.

There is an over-emphasis on investor protection in the present DR regime. The regime does not allow an issuer to issue IDRs in India unless the issuer's shares are listed and have been traded for at least three years overseas. It does not allow issue of IDRs unless QIBs are allotted half of the issue size. While these restrictions are appreciable from the perspective of investor protection, these deny a sophisticated Indian investor the opportunity to invest in IDRs that match her profile and interest. There can be classes of

⁵² See Rule 13(2)(a), Ministry of Corporate Affairs, *Companies (Registration of Foreign Companies) Rules, 2014*, see n. 45.

⁵³ See Rule 13(2)(c), *ibid.*

⁵⁴ See Rule 13(2)(b), *ibid.*

⁵⁵ See Regulation 97(b), SEBI, *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*, see n. 41.

⁵⁶ See Regulation 97(c), *ibid.*

⁵⁷ See Regulation 98(a), *ibid.*

⁵⁸ See Regulation 98(d), *ibid.*

issuers or classes of IDRs which may suit different classes of investors and the regime must allow foreign issuers and Indian investors to make a choice. It may be noted that the general approach to investor protection in India is different: no company per se is ineligible to access Indian capital market. The *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009* allow every company to access the market. It only states that if a company does not meet particular requirements, it can still make a public offer through a book building route.

Approval Process

The extant regime requires the issuer of IDRs to obtain necessary approvals or exemptions from the authorities of the home country.⁵⁹ It also requires the issuer to obtain prior written approval from SEBI on an application made in this behalf.⁶⁰ India along with the rest of the world has moved away from the requirement of approval for any issue of capital from any authority. India made a clear departure from merit based regulation when it repealed the *Capital Issues (Control) Act, 1947* in 1992 and established SEBI to usher in a disclosure based regulatory regime. Of late, SEBI has brought in limited merit based regulation which empowers SEBI to reject draft offer documents in exceptional cases.⁶¹ The requirement of approval for an issue of capital takes the country back by two decades to a merit based regulatory regime.

Institutional investors

One crucial investor pool is made up of the institutional investors. The Committee noted that there are certain restrictions under Indian laws that prevent some categories of institutional investors from participating in the DR market in India. For instance, insurance companies are prohibited under insurance laws from investing in IDRs since the proceeds are invested outside India.⁶² Similar restrictions exist for pension funds too.⁶³ Moreover, RBI does not allow grant of loan or advance for subscription to IDRs and grant of loan or advance against security or collateral of IDRs issued in India.⁶⁴ Such restrictions create unnecessary barriers to participation by institutional investors in the Indian DR market. More importantly, while the reforms have allowed freedom to issuers to raise resources in any manner subject to compliance with the requirements, it has not allowed similar freedom to investors like insurance and pension funds who invest trust money. They must have freedom to invest in a broader range of asset classes, domestic and overseas, including ADRs and GDRs, under the prudent investors' regime.

⁵⁹ See Rule 13(3)(a), Ministry of Corporate Affairs, *Companies (Registration of Foreign Companies) Rules, 2014*, see n. 45.

⁶⁰ See Rules 13(3)(b) and 13(3)(c), *ibid*.

⁶¹ See, SEBI, *SEBI (Framework for rejection of draft offer documents) Order, 2012*, General Order No. 1 of 2012, Oct. 9, 2012, URL: <http://www.sebi.gov.in/sebiweb/home/list/1/4/0/0/General-Orders> (visited on 06/01/2014).

⁶² See section 27C, *Insurance Act, 1938*; Insurance Regulatory and Development Authority (IRDA) has issued a circular to CEOs of all insurers clarifying that section 27C of the Insurance Act, 1938 prohibits insurance companies from investing in IDRs since such investment amounts to an indirect investment made outside the country. See, IRDA, *Indian Depository Receipts*, IRDA/INV/CIR/015/June 09, June 4, 2009.

⁶³ See section 25, *Pension Fund Regulatory and Development Authority Act, 2013*.

⁶⁴ See paragraph 2.3.6, RBI, *Master Circular on Loans and Advances*, DBOD.No.Dir.BC.14/13.03.00/2013-14, July 1, 2013.

This can at first be done under conventional regulation of asset allocation, but in the future there is a major role for a ‘prudent investor’ principles-based regulatory regime. This is also necessary for the growth of insurance and pensions industries, financial inclusion and economic growth.⁶⁵

Restricted fungibility

The law of one price should hold for DRs and their underlying securities since they represent the same asset.⁶⁶ When price disparities occur, an active arbitrage business should quickly eliminate those disparities. Policy makers need to establish the enabling framework through which this arbitrage becomes frictionless and delivers efficient pricing.⁶⁷

There is tremendous confusion about the mode and extent of fungibility permitted. The *Guidelines* state:⁶⁸

All the IDRs shall have partial two-way fungibility. The partial two-way fungibility means that the IDRs can be converted into underlying equity shares and the underlying equity shares can be converted into IDRs within the available headroom. The headroom for this purpose shall be the number of IDRs originally issued minus the number of IDRs outstanding, which is further adjusted for IDRs redeemed into underlying equity shares (“Headroom”).

Beyond this basic rule, the *Guidelines* impose several further restrictions, such as reservation of 20% for retail investors, redemption on proportionate basis, quarterly cycle of redemption etc. The said guidelines make effective the circular on *Redemption of Indian Depository Receipts into underlying equity shares*. This circular prohibits fungibility during the first year after the issue and limits fungibility to 25% of the original issue in any subsequent financial year.⁶⁹ Thus, there is partial two-way fungibility with several restrictions without much clarity.

Compulsory repatriation

Schedule 7 to the *FEMA 20* on issue and sale of IDRs requires the proceeds of the issue of IDRs to be immediately repatriated outside India by the issuer company. This prevents a foreign company from using the IDRs route to fund its Indian operations. Consequently, a major class of issuers have been excluded from the DR market in India.

Lack of clarity in taxation

The *Income Tax Act, 1961* does not provide for a specific framework for taxation of income emanating from IDRs. Though the IDRs have equities as underlying securities,

⁶⁵ See generally, Ministry of Finance, *Report of the Committee on Investment Norms for Insurance and Pension Funds*, tech. rep., 2013.

⁶⁶ See generally, Matthew Stigler, Ajay Shah, and Ila Patnaik, “Understanding the ADR premium under market segmentation”, in: *NIPFP Working Paper Series* (July 29, 2010), URL: http://www.nipfp.org.in/media/medialibrary/2013/04/wp_2010_71.pdf.

⁶⁷ See, M.S. Sahoo, see n. 9, paragraph 2.4.1.

⁶⁸ See paragraph 3, SEBI, *Guidelines*, see n. 42.

⁶⁹ See, SEBI, *Redemption of Indian Depository Receipts into underlying equity shares*, see n. 42; also see Schedule 7, Reserve Bank of India, *FEMA 20*, see n. 43; also see Regulation 100, SEBI, *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*, see n. 41.

the tax law does not treat IDRs as equities. First, the gain or loss arising on transfer of IDRs is taxed as capital gains when these IDRs are held as capital assets, or as business income when held as stock-in-trade. That is, if an IDR is held for more than 1 year, long term capital gains (LTCGs) tax is payable at 20% (after availing of indexation benefits) or 10% (without availing of indexation benefits). And, if it is held for less than 1 year, the short term capital gain (STCG) tax is payable at the normal tax rate applicable to the investor. In contrast, the loss or gain arising from transfer of equities on exchanges, if held for more than one year, attracts STT only, and if held for less than one year, attracts STT and STCG at 15%. Second, the income received from IDRs is not considered a dividend and hence is taxed at applicable rates, while income on equity is subject to dividend distribution tax and is not taxed in the hands of the recipient. Thus, the tax treatment of equities and that of IDRs with equities as the underlying are different. Further, the law is silent on tax treatment on conversion of IDRs into underlying equities. Section 47(x), which was introduced in the *Income Tax Act, 1961* in 1991, deals with transfer by way of conversion of DRs, and seems applicable to GDRs / ADRs but not IDRs, which emerged almost two decades later. The stakeholders are interested in equal tax treatment to equities and IDRs based on equities and tax clarity.

However, as stated earlier, this Committee envisages BhDRs which would also have non-equities as underlying securities. It is, therefore, necessary to provide a comprehensive framework for taxation of BhDRs with different underlying securities, and not only IDRs. Further, the tax should be neutral across products, that is, an investor should have similar tax liability whether she invests in equities or DRs on equities and whether she invests in domestic equities or foreign equities. These aspects have been dealt in Chapter 4.

Level playing field

India lives in the comity of nations. It cannot have an island of its own which is not compatible with and does not complement and supplement the rest of the world. It would receive the same treatment from other jurisdictions as it would treat the participants from those jurisdictions. Indian issuers and investors would receive the same treatment overseas as overseas issuers and investors would receive in India. Indian issuers would receive the same facilitation for issue of ADRs overseas as the overseas issuers would receive the facilitation for issue of IDRs in India. Therefore, for all practical purposes, the scheme for issue of IDRs needs to be a mirror image of the scheme for ADRs – India should import as much of capital market as it exports and should match the pressure of inflows by facilitating outflows.

Unified regulation

SEBI is the custodian of securities market and also the guardian of the investors. It should ideally decide who should be allowed to issue securities, including DRs, in the market and also the terms of issue and trading in India. However, the matters such as repatriation of proceeds of issue or taxation aspects may be dealt with in respective laws. There is no reason to have rules under the *Companies Act, 2013* and the regulations under the *SEBI Act, 1992* and two authorities, Ministry of Corporate Affairs and SEBI, prescribing the terms of accessing the Indian securities market. This kind of arrangement is probably due to historical reasons and that has limited the DRs to IDRs only. Ideally, the market should allow BhDRs (and not only IDRs) which may have all kinds of securities (not

only equities) issued by all kinds of issuers (not only companies) as underlying securities under the oversight of one regulator. This would create a competitive market for BhDRs which would enable better portfolio diversification for investors and lead to an overall increase in international competitiveness of the Indian securities markets.

As observed, the provisions relating to IDRs are found in different legislations as well as rules, regulations, guidelines and circulars. It is desirable, as recommended by the *Justice B.N. Srikrishna Report*, to have only one instrument of subordinate legislation, which would provide legal certainty.

For the above reasons, the present framework surrounding IDRs needs to be reviewed and streamlined to make DRs an efficient measure of international competitiveness of the Indian financial system albeit within the contours of the capital controls regime in vogue.

3 — Guiding principles

The Committee's review of the existing legal and institutional framework surrounding IDRs has been informed by the strategy for financial reforms articulated in recent expert committee reports, including the *Percy Mistry Report* (2007), *Raghuram Rajan Report* (2008), *U.K. Sinha Report* (2010) and the *Justice B.N. Srikrishna Report* (2013). The general policy direction adopted by the Committee also broadly conforms to the general policy approach underpinning the creation of the Standing Council of Experts by the Ministry of Finance in 2013 to assess the international competitiveness of the Indian financial sector.⁷⁰

3.1 Contemporary policy thinking on regulation of markets

1. *All market regulations must be informed by an analysis of potential market failures.*
2. *All financial regulation must be motivated by the objectives of consumer protection, micro-prudential regulation, systemic risk regulation or resolution.*
3. *Regulatory strategies for IDRs must be informed by this analysis.*

Some markets left to themselves may fail to produce an efficient allocation of resources. Such an event is referred to as market failure. Regulations are meant to address such market failures. This framework for thinking about market failures, when translated into the field of finance, induces a clear categorisation of the tasks of the government, as has been clarified by the Financial Sector Legislative Reforms Commission (FSLRC) (hereinafter referred to as *Justice B.N. Srikrishna Report*).

The systematic strategy for financial regulation consists of analysing the market processes and identifying interventions that fall within the following areas, identified by

⁷⁰See, Press Information Bureau, Government of India, *A Standing Council of Experts Constituted to Assess and make Recommendations Regarding the International Competitiveness of the Indian Financial Sector*, June 7, 2013, URL: <http://www.pib.nic.in/newsite/erelease.aspx?relid=96490> (visited on 02/04/2014).

the FSLRC:⁷¹

1. *Consumer protection*: Without the trust of the consumers, the financial market cannot perform its primary function of allocating resources from savers to spenders. At the same time, financial firms may have perverse incentives to exploit the trust of consumers in an unfair manner. Most consumers are in an unequal bargaining position and sometimes financial firms stand to gain out of monopolies and related rent-seeking behaviour. In this context a ‘buyer beware’ approach is not adequate. Regulators must place the burden upon financial firms of doing more in the pursuit of consumer protection. This perspective shapes interventions aimed at prevention (inducing financial firms towards fair play) and cure (redress of grievances) of consumer abuse. IDRs are Indian securities even though the underlying security may be a foreign security; they can be purchased and traded by Indian investors in India. Therefore, the entire framework of consumer protection as is applicable to any Indian security should also apply to IDRs.
2. *Micro-prudential regulation*: When a financial firm makes promises to consumers, regulators are required to monitor the probability of the financial firm failing to honour its promise and undertake interventions that reduce this probability. The higher the intensity of promise, the stricter should be the regulations. Otherwise, if financial firms are allowed to go back on their promises with impunity, consumers’ faith in the financial system will be hampered. An example is the faith reposed by consumers depositing money with regulated banks. Indian securities law does not provide for micro-prudential requirements to be met by the issuers of Indian securities. IDRs being Indian securities should be treated alike.
3. *Systemic risk*: Micro-prudential regulation addresses the possibility of collapse of one financial firm at a time. A very different point of view is required when addressing the possibility of the collapse of the entire financial system. This calls for measurement of systemic risk, and undertaking interventions at the scale of the entire financial system (and not just one sector) that diminish systemic risk. As explained above, the law on IDRs is not concerned with the micro-prudential requirements of the issuer. Similarly, it need not be concerned with systemic risk aspects either.
4. *Resolution*: Micro-prudential regulations reduce the probability of firm failure. However, eliminating all failure is neither feasible nor necessary. At the same time, failure of large financial firms can be highly disruptive for households that are customers of the failing firm. This requires a specialised ‘resolution mechanism’ to ensure orderly resolution of troubled firms before they reach the stage of insolvency. The resolution of foreign issuers of the underlying for the IDRs is neither the mandate of the Indian law nor required.

Considering the crucial role that IDRs can play in improving the international competitiveness of the Indian financial system, devising a sound regulatory framework for IDRs assumes importance. These regulations must be aimed at addressing market failures in the IDR market.

⁷¹See, B.N. Srikrishna, *Report of the Financial Sector Legislative Reforms Commission*, tech. rep., Government of India, 2013.

3.2 Contemporary policy thinking on competitiveness

1. *Indian policy makers agree that the Indian financial sector must be internationally competitive.*
2. *It is important to objectively assess the level of international competitiveness of the Indian financial sector. IDRs provide an objective parameter on which the international competitiveness of the Indian financial system can be measured.*
3. *IDRs play a crucial role in diversifying investment risks of Indian investors.*

3.2.1 Percy Mistry Report

The *Percy Mistry Report* defines IFCs as financial centres that cater to customers outside their own jurisdiction. The Committee recommended that India must create such an IFC which will be a producer and exporter of International Financial Services (IFSs) and capture an increasing share of the rapidly growing global IFS market. To achieve these objectives, India must compete with other IFCs. The Committee delineated a list of the eleven services which India must provide in order to compete with other IFCs. One of them is fund raising. Fund raising may be by individuals, corporations and governments (sovereign and sub-sovereign). The funds may be raised in the form of debt and quasi-debt across maturity/currency spectra, and in the form of equity and quasi-equity for private, public and public-private corporations.⁷² IDRs are a step in this direction. IFCs also offer global/regional exchange trading of financial securities, commodities and derivative contracts in financial instruments or indices. The report noted that multiple listings of financial securities (equities and debt), derivatives and commodity contracts, on different exchanges are increasing. It argued that Mumbai has all the prerequisites to provide these services. By catering to foreign customers, IDRs and other domestic DRs will act as a parameter on which India's international financial competitiveness can be objectively measured.

3.2.2 Raghuram Rajan Report

The *Raghuram Rajan Report* points out that India should relieve pressure from inflows of capital by becoming more liberal on outflows. For instance, greater outward investment by provident funds and insurance companies should be encouraged. It explains that such diversification will make these funds more stable by insulating them from the high volatility of Indian markets. Restricting investment options to domestic government securities may greatly limit future returns and increase risk.⁷³ IDRs facilitate investments by Indian investors in Indian rupees across foreign underlying assets and thereby help in achieving this diversification of investment risks.

3.2.3 Standing Council of Experts

In June 2013, the Ministry of Finance set up a Standing Council of Experts with a view to assess the international competitiveness of the Indian financial sector and recommend measures aimed at achieving greater competitiveness.⁷⁴ It must examine the cost of

⁷²See pp. xv-xvii, Percy Mistry, see n. 1.

⁷³See pp. 6-7, Raghuram Rajan, *Hundred small steps: Report of the Committee on Financial Sector Reforms*, tech. rep., Planning Commission of India, Sept. 12, 2008.

⁷⁴See, Press Information Bureau, Government of India, see n. 70.

doing business through the Indian financial system and take into account client needs as per global standards. The creation of this Council is a concrete step to improve the international competitiveness of the Indian financial sector. Improving the legal and institutional framework for IDRs will facilitate this policy decision.

3.3 Contemporary policy thinking on investor protection

1. *All entities offering securities market related products in the overseas market, who offer these to residents in India, should register with SEBI.*
2. *Safety and soundness of the financial system should be pursued in a manner that minimises impact on innovation and competition.*

3.3.1 U.K. Sinha Report

The *U.K. Sinha Report* highlights the challenges facing the IDR market in some detail. It identifies existing legal bottlenecks in creating an ecosystem for IDRs.⁷⁵

- Restricted availability of shares;
- Lock-in periods before redemption;
- Limited two-way fungibility; and
- Forced sales for investors in IDR.

The *U.K. Sinha Report* cautions that investing and trading in financial investments overseas could expose Indian investors to risks stemming from lack of transparency and fairness. Therefore, it recommends that all entities offering securities market-related products in the overseas market, who offer these to residents in India, should register with SEBI and should be subject to adequate disclosure norms.⁷⁶

3.3.2 Justice B.N. Srikrishna Report

Competition creates incentives for innovation. This in turn influences the efficiency of financial intermediation and quality of financial products. The *Justice B.N. Srikrishna Report* explicitly recognises that greater competition, in tandem with a sound and well-functioning consumer protection framework, is a powerful tool for consumer welfare. Safety and soundness of the financial system should be pursued in a manner that minimises impact on innovation and competition.⁷⁷ In this context, the report notes that the viability of an onshore financial system is an important measure of international competitiveness.⁷⁸ As mentioned above, IDRs will act as a parameter on which India's international financial competitiveness can be objectively measured.

3.4 Harmonising depository receipts with capital controls

1. *Capital controls are a part of Indian economic regulation.*
2. *Capital controls need to be balanced with the concerns for international financial competitiveness provided through IDRs.*

⁷⁵See pp. 91-94, U.K. Sinha, *Report of the Working Group on Foreign Investment*, tech. rep., Department of Economic Affairs, Ministry of Finance, July 30, 2010.

⁷⁶See pp. 94, *ibid.*

⁷⁷See p. 65, B.N. Srikrishna, see n. 71.

⁷⁸See p. 65, *ibid.*

3. *Capital control norms need to be rationalised and streamlined to address potential market failures only.*

The IDR and the underlying foreign security are one and the same asset. The law of one price holds. In case there is any price differential between the two, arbitrage in a liquid market will quickly eliminate the disparity. But India uses capital controls as part of its macroeconomic policy tool-kit to regulate capital flows. Capital controls hamper arbitrage by restricting free inflow and outflow of funds from the economy. To this extent, there is a tension between the functioning of the IDR market and the approach to capital controls.

Indian laws prohibit any person resident outside India from issuing or transferring any security in India unless generally or specifically permitted.⁷⁹ Similarly, an Indian entity is also prohibited from issuing any security to a person resident outside India unless generally or specifically permitted.⁸⁰ However, eligible foreign companies are allowed to issue IDRs through a domestic depository to persons resident in India and outside India subject to certain conditions.⁸¹ These conditions are:⁸²

- Proceeds of the issue of IDRs must be immediately repatriated abroad by the eligible company issuing IDRs;
- IDRs cannot be redeemed into the underlying equity shares before the expiry of one year from the date of issue; and
- Limited two-way fungibility of IDRs is permitted subject to terms and conditions stipulated by RBI and SEBI.

Even after one year lock-in, an IDR holder cannot freely cancel the IDR and hold the underlying security. The Indian laws provide that no person resident in India is allowed to make any direct investment outside India or in a foreign entity engaged in real estate or banking business, unless generally or specifically permitted.⁸³ Listed Indian companies, mutual funds and Indian parties engaged in the financial sector in India are allowed to invest in certain types of foreign securities subject to certain conditions.⁸⁴ Accordingly, any such entity holding IDRs, on cancellation, must sell or continue to hold the underlying foreign shares subject to these conditions.⁸⁵ Other persons resident in India including resident individuals may hold the underlying securities only for the purpose of sale within 30 days from the date of conversion.⁸⁶

These restrictions imposed on IDR issuers as well as holders restrict free fungibility and makes it difficult for the law of one price to prevail between the underlying and the corresponding IDRs. It is important to modify capital controls in order to pursue international financial competitiveness provided through IDRs. The Committee is of the view that these capital control regulations should only be motivated by the need to address market failures.

⁷⁹See Regulation 3, Reserve Bank of India, *FEMA 20*, see n. 43.

⁸⁰See Regulation 3, *ibid*.

⁸¹See Regulation 13, *ibid*.

⁸²See Schedule 7, *ibid*.

⁸³See Regulation 5, Reserve Bank of India, *Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004*, Notification No. FEMA 120/2004-RB dated 7-7-2004, July 7, 2004.

⁸⁴See Regulations 6B, 6C and 7, *ibid*.

⁸⁵See paragraph 7, Reserve Bank of India, *Issue of Indian Depository Receipts*, July 22, 2009; and, Regulation 22(7), Reserve Bank of India, *FEMA 120*, see n. 83.

⁸⁶See Regulation 22(7)(ii)(c), Reserve Bank of India, *FEMA 120*, see n. 83.

4 — Issues and Responses

Based on internal deliberations as well as consultations with the stakeholders, the Committee identified the policy issues relevant to IDRs and analysed them in depth, keeping in view the principles of law, economics and regulations enunciated in earlier chapters. In this section, each policy issue is framed as a question, and the Committee's corresponding recommendations are stated, accompanied by an explanation for the same based on the data analysis, comparative legal study and the guiding principles discussed before.

4.1 Should issue and trading of DRs be allowed?

The Committee is of the view that DRs should be issued and traded in India to make the Indian financial system more competitive, and to provide greater choice to Indian investors. Nevertheless, the Indian State must neither promote nor discourage issuance and or trading of DRs and the law must address only potential market failures, if any.

As the world moves towards further integration of national markets, countries can optimise development by removing artificial barriers that prevent the free flow of goods and services as well as the factors of production. The Committee has previously recommended that Indian firms should have a viable option of raising resources from international capital markets by issuing ADRs/GDRs. Similarly, India must reciprocate by allowing a viable option for foreign firms to raise resources from the Indian capital market. While the former may entail export of Indian capital market, the latter would compensate for that by import of capital market. While the former would bring pressure of capital inflows, the latter would ease the pressure by permitting outflows. This would create the competitive dynamics necessary to enhance the efficiency of the domestic Indian capital market.

Allowing DRs in India broadens the range of products that can be offered to investors in this jurisdiction, creating opportunities for issuers and providers of financial services to create markets. Greater participation by foreign issuers in the Indian financial system

will provide competitive pressure on the system to meet global best practices. Moreover, it will provide greater choice to Indian investors and will enable them to diversify their portfolios globally, just as it is feasible and permitted for investors living in mature market economies all over the world. As stated in Chapter 2.4.2, the standard deviation of daily returns for the years 2004 to 2013 is 1.65% for a NIFTY index fund, while it is 0.93% for the same period for an equally weighted portfolio of 12 country index funds, including NIFTY. In other words, an internationally diversified portfolio in the form of IDRs is beneficial for domestic investors compared to a domestically concentrated investment portfolio. Therefore, the Committee recommends providing greater choice to Indian investors in the form of IDRs.

However, the Committee is of the view that state intervention is necessary only to address potential market failures as discussed in Chapter 3.1. In the absence of any such possibility, the state should neither discourage nor promote issuance of domestic DRs. The present legal and institutional structure supporting the issuance and trading of domestic DRs should be streamlined to address specific market failures. Subsequently, it is for the economic agents to utilise the domestic DRs route as per their commercial prudence.

4.2 What should be the underlying securities for DRs?

The Committee recommends that if a particular foreign security is accessible to an Indian investor under the extant capital control regime, the DRs on those securities should also be available to her. It, therefore, recommends BhDRs only on those foreign securities which are available to a person resident in India under the capital controls regime in vogue.

The *Companies Act, 2013* defines IDR as under:⁸⁷

“Indian Depository Receipt” means any instrument in the form of a depository receipt created by a domestic depository in India and authorised by a company incorporated outside India making an issue of such depository receipts;

Though the definition is neutral to the underlying security on the back of which an IDR can be issued, the Rules notified under section 390 of the *Companies Act, 2013* limits the underlying security to equities only.⁸⁸ Further, these underlying securities can only be securities of a company incorporated outside India. Thus, the IDRs can be issued only on the back of equities of companies incorporated outside India and, that too with the authorisation of the company.

As stated earlier, India has a capital controls regime. This allows Indian investors to invest in certain categories of foreign securities. For example, a listed Indian company has a general permission to invest in shares of an overseas listed company, rated bonds or fixed income securities issued by such companies.⁸⁹ Individuals are permitted to

⁸⁷ See section 2(48), *Companies Act, 2013*.

⁸⁸ See Rules 13(3)(j), 13(6)(a), 13(6)(b) and 13(7)(b), Ministry of Corporate Affairs, *Companies (Registration of Foreign Companies) Rules, 2014*, see n. 45.

⁸⁹ See Regulation 6B, Reserve Bank of India, *FEMA 120*, see n. 83.

make investment in foreign securities of specified types up to \$ 1,25,000.⁹⁰ Mutual funds are also permitted to make investments within specified limits in shares of the rated bonds, in fixed income securities of an overseas company listed on a recognised stock exchange or in exchange traded funds, or in other securities as may be stipulated by RBI.⁹¹ Broadly speaking, these restrictions have been steadily eased over the years, as part of the process of modernisation and liberalisation of Indian economic policy. Therefore, the set of foreign securities and the amount of investment in such securities would keep on changing depending on policy imperatives of the economy.

Since the DR is essentially the same asset as the underlying security, Indian investors should have the same access to DRs as they have to the underlying securities. If a foreign security is available to Indian investors under the capital controls regime, that foreign security must also be available to serve as the underlying security for issuance of DRs in India. There is nothing further to be gained by distorting an Indian investor's choice of investing in foreign securities or a foreign issuer's choice of participating in the Indian securities markets. The Committee is of the view that the law should be neutral with respect to an Indian investor's choice of the mode of purchasing foreign securities, and should also be neutral with respect to the foreign issuer's choice of mode of raising resources as long as the basic capital controls are complied with. Therefore, the Committee recommends allowing DRs to be issued on the back of any foreign security, whether debt or equity, or whether issued by a company or otherwise, and whether the issuance of the DR has been authorised by the issuer or not, as may be permitted under the capital control regime in vogue.

Let us assume that there are three kinds of Indian investors, namely, A, B and C. Let us further assume that the capital control regime allows A to invest in three kinds of foreign securities, namely, L, M and N; B to invest in P, Q and R; and C to invest in X, Y and Z. Therefore, the DRs on the back of L, M or N would be available to A; the DRs on the back of P, Q or R would be available to B; and the DRs on the back of X, Y or Z would be available to C subject to the condition that their investments in foreign securities and the DRs on the back of such foreign securities taken together do not exceed the permissible limit.

For convenience, the Committee refers to these foreign securities (L, M, N, P, Q, R, X, Y, Z) as 'permissible securities' and the DRs based on these securities as 'Bharat Depository Receipts (BhDRs)' and recommends that BhDRs, based on foreign securities, be made accessible to Indian investors. IDRs, as defined in the *Companies Act, 2013* would be a sub-set of BhDRs. The Committee notes that the set of permissible securities available to an Indian investor would expand or contract from time to time, and hence BhDRs would be available on a floating set of foreign securities at different points of time.

This means that the underlying security for IDRs would continue to be the equity shares of the companies and any investor would be allowed to invest in these as per the current framework without any restriction on investments by an investor. Other than IDRs, BhDRs would include other depository receipts which will be issued on the back

⁹⁰See, RBI, *Liberalised Remittance Scheme (LRS) for resident individuals-Increase in the limit from USD 75,000 to USD 125,000*, A.P. (DIR Series) Circular No.138, June 3, 2014, URL: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=8918&Mode=0> (visited on 06/05/2014).

⁹¹See Regulation 6C(1), Reserve Bank of India, *FEMA 120*, see n. 83.

of foreign securities that are currently available to listed companies, mutual funds and resident Indians under the extant capital control regime. These would also include DRs on debt issues, unsponsored issues and non-capital raising equities of a company.

Mr. S. Ravindran, a member of the Committee, is of the view that allowing a wider range of securities may lead to exotic derivatives being used as underlying. The Indian market presently may not be mature enough for such kind of complex instruments. This may lead to concerns regarding such products being marketed and sold to unsuspecting investors. A more mature market and greater level of investor awareness may be necessary before introducing such products.

4.3 What should be the extent of regulations of BhDRs?

The Committee is of the view that the issuance or trading of BhDRs in India need to be regulated to the extent necessary to protect Indian investors in such instruments and to harmonise the DR related transactions to the extant capital controls regime.

A review of contemporary policy thinking in India suggests that there is only one sound economic reason for regulating domestic DRs, and that is consumer protection. This Committee has in its previous report argued that the only market failure of concern to the Indian authorities in the ADR market relates to the protection of Indian investors.⁹² The same concern exists for BhDRs as these are available to Indian investors. Each country has domestic laws to safeguard the interests of investors within its jurisdiction. Therefore, suitable regulations are necessary to protect the Indian investors in BhDRs.

India uses capital controls as part of its macro-economic toolkit to regulate capital flows. The existing capital controls provide for partial two-way fungibility and a one year lock-in for IDRs. These restrictions severely affect the market for IDRs. The Committee is of the view that the present capital controls regime needs to be refocused upon the issue of market failures while allowing DRs on the back of all foreign securities that are accessible to Indian investors. For a detailed discussion, see Chapters 3.3 and 3.4.

4.4 How to protect the interests of investors in BhDRs?

The Committee concludes that IDRs are ‘securities’ under the Indian law and hence protections available with securities are available to investors in IDRs. The Committee, however, recommends that the Central Government should notify BhDRs as ‘securities’ under the Securities Contracts (Regulation) Act, 1956. The comparable investor protection framework applicable to domestic securities must apply to BhDRs.

The Committee deliberated at length whether BhDRs, including IDRs, would be considered as ‘securities’ under the extant legal regime. If these are securities under the *Securities Contracts (Regulation) Act, 1956*, then the investor protection framework available to ‘securities’ would become available to investors in BhDRs.

A view emerged that since IDRs are listed on recognised Indian stock exchanges and are issued under the *SEBI (Issue of Capital and Disclosure Requirements) Regulations*,

⁹²See Chapter 3.4, M.S. Sahoo, see n. 9.

2009, they are securities. There was also a contrary view that mere listing of an instrument on a recognised Indian stock exchange does not make it ‘security’ under the Indian law.⁹³

The definition of ‘securities’ in the *Securities Contracts (Regulation) Act, 1956* does not specifically include IDRs or ‘depository receipts’. Section 2(h) of the *Securities Contracts (Regulation) Act, 1956* defines ‘securities’ as under:

‘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**;

...

(iia) such other instrument as may be declared by Central Government to be securities; and

(iii) rights or **interest in securities**;

Section 2A of the *Securities Contracts (Regulation) Act, 1956* incorporates definitions from the *Companies Act, 1956* into the *Securities Contracts (Regulation) Act, 1956* by reference. A ‘body corporate’ is defined in the *Companies Act, 1956* to include any company incorporated outside India.⁹⁴ Therefore, any marketable security of a company incorporated anywhere outside India is a ‘security’ in the eyes of Indian law. Moreover, an ‘interest in securities’ is also a ‘security’. IDRs on an underlying ‘security’ being an interest on such ‘security’ are covered within the ambit of ‘securities’. Therefore, the Committee concludes that IDRs issued on the back of marketable securities of a company incorporated outside India are ‘securities’ under Indian laws.

However, the Committee notes that BhDRs may be issued on the back of securities issued by entities other than a body corporate or on non-equity securities issued by a body corporate. Moreover, instruments which are considered as ‘securities’ in a foreign jurisdiction may not be considered so under the Indian laws.⁹⁵ Therefore, doubts may arise as to whether all kinds of BhDRs would be considered as ‘securities’ under the Indian laws. The Committee notes that section 2(h)(iia) of the *Securities Contracts (Regulation) Act, 1956* empowers the Central Government to declare any instrument as ‘securities’.⁹⁶ The Committee is of the view that the Central Government should issue a notification under section 2(h)(iia) of the *Securities Contracts (Regulation) Act, 1956* declaring BhDRs as ‘securities’, where BhDRs would mean DRs issued on the back of permissible foreign securities and include IDRs. This will give Indian authorities the

⁹³Exim policies, which are not considered as ‘securities’, used to be traded on stock exchanges in India.

⁹⁴Certain entities are excluded from the definitions. See section 2(7), *Companies Act, 1956*; also see section 2(11), see n. 87.

⁹⁵In UK, unlike India, ‘securities’ are defined as anything which has been, or may be, admitted to the official list. See section 102A(2), *Financial Services and Markets Act 2000*.

⁹⁶The SEBI Act, 1992 amended the *Securities Contracts (Regulation) Act, 1956* to empower the Central Government to declare any other similar instrument to be securities. This was done to avoid frequent amendments to the *Securities Contracts (Regulation) Act, 1956* because that would be very time consuming. See, M.S. Sahoo, “Historical perspective of securities laws”, in: *NSE News* (Feb. 2005).

required jurisdiction to protect investors in BhDRs and such investors would enjoy the same protection as available in relation to any other securities in India.

Once the regulators have a clear mandate to regulate the market, they should provide investor protection measures through regulations. These measures would include allowing only investors of a certain level of sophistication to enter certain markets; allowing only certain types of securities or issuers to offer products in certain markets; requiring initial and ongoing disclosure by issuers; imposing liabilities on appropriate entities; and providing accessible avenues for recourse, etc.

The Committee studied the successful DR frameworks in US and Brazil. The design of these DR regimes involves providing different classes of investors with appropriate protections. For example, only QIBs can invest in Rule 144A ADRs in the US. The disclosure norms for this segment are less stringent than for the other segments in which retail investors are allowed to invest. This ensures that issuers have the option to choose from different categories of DRs best suited for their commercial needs without compromising the protection of unsophisticated or retail investors. The Committee recommends that SEBI should create, at a minimum, two 'levels' of BhDRs: Level-I should be restricted to sophisticated investors and Level-II should be available for all investors, including retail Indian investors. The issuers accessing the Indian securities markets through the Level-I framework should have a lower regulatory burden but can access only sophisticated investors where each market lot would be a minimum of one million rupees. In other words, the smallest unit in which the securities could be traded should be Rs. 1 million, which would keep out unsophisticated investors. SEBI may explore alternative ways of defining sophisticated investors, as has been done in the US⁹⁷ and EU⁹⁸, as sophistication may not be fully captured by market lot size.

However, SEBI should have the discretion to create different sub-levels under Level-I for different classes of sophisticated investors, and accordingly to vary the level of protection provided and the disclosure norms imposed. The issuers using the Level-II framework must be given the same treatment as is given to an Indian issuer of securities that are accessible to all Indian investors. The regulations must move away from a 'one-size-fits-all' approach; and instead provide for a variety of DRs that would match different profiles of investors.

⁹⁷Regulation D of the US securities laws creates some of the exemptions to the SEC's stringent registration requirements, all of which involve sales to "accredited investors". Rule 501 of Regulation D defines "accredited investors" to include certain kinds of organisations and corporate forms, as well as natural persons who meet specific net worth or income requirements. See *Regulation D*, URL: <http://www.ecfr.gov/cgi-bin/text-idx?SID=c596b30776eed01dfc0b2d2e58167be9&node=17:3.0.1.1.12.0.46&rgn=div7>, 17 CFR Section 230.501 et seq.

⁹⁸The EU allows certain clients to be treated as professionals upon request. To be assessed as such, the client must meet at least two of the following criteria:

- the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;
- the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds EUR 500 000;
- the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

See *Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC* [Official Journal L 145 of 30.4.2004].

The Committee further recommends that BhDRs may be issued only on those underlying securities which are listed on an international exchange which is accessible to the public for trading and provides pre-trade and post-trade transparency to the public. This would ensure protection through initial and continuous disclosures. However, Mr. S. Ravindran and Mr. G. Padmanabhan, members of the Committee, feel that DRs may be allowed only on those underlying securities that are listed on public platforms of international stock exchanges accessible to retail investors of the respective jurisdictions. According to them, this would ensure a level playing field as these DRs would be listed on public platforms of Indian stock exchanges and only such foreign securities which are subject to stricter scrutiny and regulatory standards are used as the underlying.

A few members of the Committee feel this unreasonable particularly in the context where India allows unlisted companies to issue ADRs/GDRs. Mr. M.S. Sahoo in particular feels that this would also restrict availability of securities for BhDRs in the sense that there are many securities, such as units of overseas mutual funds, which are otherwise available to Indian investors but are not required to be listed. This will rule out the possibility of having BhDRs on units of mutual funds and other similar securities. This essentially means that an Indian investor can invest in the units of overseas mutual funds but not in BhDRs issued on the back of such units.

The investors in BhDRs need to be protected from market abuse as well as corporate frauds. The Indian securities markets need to be protected from money laundering. Keeping in mind these concerns, the Committee recommends that the issuer of the underlying foreign security must be from a 'permissible jurisdiction' which is under legal obligations to share information and cooperate with the Indian authorities in the event of any investigation, i.e., it must be a Financial Action Task Force (FATF) and International Organization of Securities Commissions (IOSCO) compliant jurisdiction. Such 'permissible jurisdiction' would mean a jurisdiction:

- whose securities regulator is a signatory of the IOSCO Multilateral Memorandum of Understanding (MMoU) framework or has a bilateral cooperation agreement with SEBI; and
- which is a member of the FATF.

Dr. Ajay Shah, a member of the Committee, is of the view that this would needlessly shut off the issuers from South Asia and East Africa who are not members of IOSCO or FATF and, therefore, he would prefer relaxation of this requirement.

The Committee is further of the view that the underlying foreign security must be in dematerialised form. This is necessary for convenience in gathering data and information regarding the issue of the underlying securities, fungibility and for reconciliation and investigation purposes. This would also enable the depositories to disseminate the extent to which underlying securities have been used for BhDRs and the headroom available for conversion from BhDRs to underlying and vice versa.

4.5 Who can provide the underlying for the BhDRs?

The Committee recommends that any foreign issuer should be able to issue fresh securities on the back of which BhDRs may be issued in India by a domestic depository. However, an issuer barred by the regulator of home jurisdiction, any other regulator or court of law from accessing capital markets should not be allowed to sponsor BhDRs. It

further recommends that any person holding listed securities issued by foreign issuers should be able to transfer those securities which may be deposited with a foreign custodian and, on the back of such securities, BhDRs may be issued in India by a domestic depository.

The foreign issuers of permissible securities, which are available to Indian investors under the extant capital control framework, should be eligible to sponsor BhDRs. That is, they can issue securities on the back of which BhDRs may be issued in India by a domestic depository. This is of course subject to measures that are required from the perspective of consumer protection as described above. Those measures include the requirements that the underlying securities need to be listed on an international exchange; that the issuer must be from a FATF and IOSCO compliant jurisdiction; that the issuer should not have been debarred from accessing capital market by the regulator of home jurisdiction or any competent court of law, etc. Beyond this, no issuer should be ineligible to sponsor underlying securities for issue of BhDRs. SEBI, the guardian of the securities market, may lay down different eligibility criteria or standards for issuers/ underlying securities and different compliance requirements keeping in view the kind of investors allowed to invest in such BhDRs. For example, it may specify that issuers may sponsor BhDRs, which may be available to retail investors, only if 50% of the issue is subscribed by institutional investors.

Un-sponsored DRs is a major component of DR market worldwide. These are issued without the authorisation or involvement of the issuer of the underlying foreign securities. The definition of IDR in the *Companies Act, 2013* requires an authorisation from the issuer for issue of DRs in India. Therefore, un-sponsored IDRs are beyond the scope of the *Companies Act, 2013* and are not presently permissible. However, the Committee believes that if an Indian investor can buy a particular underlying foreign security, there is no reason to disallow her from buying a DR on such a security just because it is not sponsored by the issuer. However, SEBI may restrict availability of un-sponsored DRs for certain categories of investors.

Mr. S. Ravindran, a member of the Committee, is of the view that un-sponsored issuance of DRs should not be permitted at all because these carry concerns of protection of Indian investors in case of fraud by the issuer and the authorities may be legally handicapped to take action against such issuer in the absence of authorisation to issue DRs in India.

4.6 For what purposes can BhDRs be issued in India?

The Committee recommends that BhDRs can be issued for both capital raising and non-capital raising purposes. Further, proceeds from BhDR issues may be repatriated or used within India and no end use restrictions must be imposed.

Issuance of BhDRs in India may be motivated by various commercial considerations, as discussed in Chapter 2.4.3. Capital raising is one of them. There may be non-capital raising purposes too. The present Indian laws, however, do not envisage the possibility of non-capital raising IDRs. The Committee notes that both the US and Brazil have successfully created multiple avenues, with differentiated reporting burdens and costs,

that allow firms to pursue a variety of non-capital raising objectives in their jurisdictions. Moreover, from a consumer protection perspective, there is no extra risk imposed for non-capital raising BhDRs in comparison to capital raising BhDRs. Therefore, there is no rationale for forbidding non-capital raising issues. The Committee recommends that domestic DRs may be issued for capital raising as well as non-capital raising purposes.

The Committee was informed during the stakeholders' meetings that foreign issuers may potentially use the IDR route to fund their Indian operations. However, under the present legal regime, the proceeds of an IDR issue must immediately be repatriated outside India.⁹⁹ This rule in effect excludes a large category of potential IDR issuers looking at utilising the proceeds from the IDR issue within India. The Committee observes that there is no concern if the proceeds of the IDR issue are utilised in India. It will only help the Indian capital market better serve the domestic real economy. Therefore, it is recommended that this restriction should be removed. Further, no end use restrictions must be placed on the proceeds from BhDRs as long as it is serving the domestic real economy.

4.7 Should there be limits on the issue size of BhDRs?

The Committee recommends that the issue size of BhDRs should be restricted to 25% of the class of listed foreign securities used as underlying securities. Further, when the aggregate market value of outstanding BhDRs reaches a predetermined threshold, the BhDR framework should be reviewed.

The *IDR Rules, 2004* allowed IDRs to be issued by any issuing company up to 15% of its paid up capital and free reserves in any financial year.¹⁰⁰ In view of the Committee's recommendation that the underlying must be listed in a permissible jurisdiction, this requirement does not serve any consumer protection purpose. However, there were some reservations regarding the possibilities of market abuse if 100% of a class of foreign securities are allowed to be used as underlying securities for issuance of domestic DRs. Therefore, the Committee recommends that the issuance size of BhDRs should be restricted to 25% of the class of underlying listed foreign securities. In fact, this has been provided recently in the *Companies (Registration of Foreign Companies) Rules, 2014*.¹⁰¹

The amount directly invested in foreign securities and the amount invested through BhDRs are fungible subject only to the overall limit, as mandated by India's capital control regime. Therefore, there should be no restriction on the amount that can be invested in BhDRs as long as investors are investing within their permissible limits. However, as is well known, many investors do not invest in foreign securities to the full extent of their entitlement or at all. One is not too sure, how much such investors would use their entitlement to invest in BhDRs in view of the home bias. Therefore, the Committee recommends that when the aggregate market value of outstanding BhDRs

⁹⁹ See Entry 1(e), Schedule 7, Reserve Bank of India, *FEMA 20*, see n. 43.

¹⁰⁰ See Rule 6(iii), Ministry of Corporate Affairs, *Companies (Issue of Indian Depository Receipts) Rules, 2004*, Notification number GSR 131(E) dated 23rd February 2004.

¹⁰¹ See Rule 13(7)(b), Ministry of Corporate Affairs, *Companies (Registration of Foreign Companies) Rules, 2014*, see n. 45.

(excluding IDRs) reaches a threshold in relation to GDP, the BhDR framework should be reviewed. There should be no limits on investments in IDRs, as is the norm at present.

4.8 Should BhDRs be listed in India?

The Committee recommends that BhDRs must be listed on a recognised stock exchange in India and SEBI should have the authority to specify different listing standards for varying level of BhDRs.

Indian law requires that if any security is issued to more than fifty persons, it must be listed on a recognised stock exchange.¹⁰² The Committee is of the view that most BhDR issues will require listing under this legal regime. This will be beneficial from the standpoint of consumer protection too. However, SEBI must ensure that the disclosure burden on the issuer of BhDRs is proportional to the sophistication of the investors allowed to invest in a particular level of domestic BhDRs. In other words, the lower is the sophistication of the investors allowed in a level of BhDRs, the higher should be the disclosure requirement on listing such BhDRs.

4.9 Should the pricing of BhDRs be regulated?

The Committee recommends that the pricing of BhDRs should not be regulated.

As has been discussed in Chapter 2, DRs and their underlying securities represent the same asset. Therefore, the price of the BhDRs will be a function of the price of the underlying. The market will, therefore, discover the price of BhDRs and no regulations are needed for this. However, the regulations should allow two way fungibility which would remove price arbitrage.

4.10 What should be the extent of fungibility?

The Committee recommends that full two-way fungibility should be allowed to the extent of the issue size of BhDRs.

Full two-way fungibility allows an investor to convert DRs into the underlying securities and also to convert the underlying securities back into DRs. This enables arbitrage and consequently helps to maintain the law of one price between the DR and its underlying securities.¹⁰³

The Union Budget speech of March 16, 2012 proposed ‘permitting two-way fungibility in IDRs subject to a ceiling with the objective of encouraging foreign participation in Indian capital market’.¹⁰⁴ Pursuant to this, SEBI permitted partial fungibility of IDRs

¹⁰² A higher number may be prescribed by the Central Government. See sections 40 and 42, see n. 87; and Supreme Court of India, *Sahara India Real Estate Corporation Ltd. v. Securities and Exchange Board of India*, (2013) 1 Supreme Court Cases 1, paragraph 96, per Radhakrishnan, J.

¹⁰³ See generally, Stigler, Shah, and Patnaik, see n. 66.

¹⁰⁴ See paragraph 37, Ministry of Finance, *Speech of Pranab Mukherjee*, tech. rep., Mar. 16, 2012, URL: <http://indiabudget.nic.in/ub2012-13/bs/bs.pdf> (visited on 02/02/2014).

in a financial year to the extent of 25% of the IDRs originally issued.¹⁰⁵ The reason for allowing ‘partial’ and not ‘full’ fungibility was to ‘retain the domestic liquidity’ as stated in the same circular. However, there has been some relaxation in the circular *Guidelines* which imposes several restrictions on fungibility while reinforcing partial fungibility.¹⁰⁶

Investors convert IDRs/BhDRs into the underlying securities when the IDRs/BhDRs are cheaper in relation to the underlying and vice versa. Restricting two-way conversion would prevent an investor from using effective arbitrage and distort the law of one price. Further, a lack of domestic liquidity may not be a concern as there is a likelihood of unsponsored BhDRs entering the market, while the investor has an option of exiting by converting into underlying. Therefore, the Committee recommends two-way fungibility of BhDRs to the extent of the issue size.

4.11 Should holders of BhDRs have voting rights?

The Committee recommends that Indian law should be neutral to the presence or absence of voting rights in favour of BhDR holders.

Whether voting rights will be enjoyed by the BhDR holders is a matter of contractual discretion for the BhDR holders and the issuer of the underlying securities. If such rights are enjoyed by BhDR holders, the exercise of such right may affect control of the foreign issuer. Since the foreign issuer is not constituted under Indian securities or company law, Indian authorities should not be concerned about the change in control of the issuer, as they may be concerned about ADRs of Indian issuers carrying voting rights. Therefore, the Committee recommends that Indian law should be neutral to the presence or absence of voting rights in favour of BhDR holders.

4.12 Who can be a foreign custodian?

The Committee recommends that a regulated entity which has permission to perform the role of a securities custodian under the laws of a permissible jurisdiction may act as a foreign custodian for the underlying securities.

A foreign custodian is the entity with which the underlying foreign securities are deposited and against such deposited securities the BhDRs are issued in India. The Committee has already recommended that the underlying foreign securities of an issuer in a permissible jurisdiction must be listed on an international exchange in a permissible jurisdiction. Thus, in most situations, the foreign custodians should also be governed by the laws of a permissible jurisdiction. However, the Committee would still recommend

¹⁰⁵ See paragraph 4, SEBI, *Redemption of Indian Depository Receipts into underlying equity shares*, see n. 42; for a general overview of the evolution of the law on two-way fungibility, see Aditya Shukla, Ruchi Biyani, and Vyapak Desai, “Indian depository receipts: Limited two-way fungibility allowed”, in: *Nishith Desai Associates Corpsec Hotline* (Sept. 10, 2012), URL: http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/indian-depository-receipt-limited-two-way-fungibility-allowed.html?no_cache=1&cHash=9f94efeb3eb8a69909521692333179ee (visited on 02/04/2014).

¹⁰⁶ See, SEBI, *Guidelines*, see n. 42.

that any entity which can perform the role of a securities custodian under the laws of a permissible jurisdiction may act as a foreign custodian for the underlying securities.

4.13 Who may issue BhDRs in India?

The Committee recommends that a domestic depository specifically having permission to carry on the business of issuing BhDRs may issue BhDRs in India. Such a depository shall have obligation to comply with the provisions relating to issuance and trading of BhDRs in India.

The foreign securities underlying the IDRs are issued by foreign entities outside India. These are deposited with overseas custodian banks outside India. Against such foreign securities, IDRs are currently issued in India by a domestic depository. The depository does so at the behest of the issuer of the underlying. This is the practice for issue of DRs the world over.

This Committee has recommended permitting BhDRs, which are more expansive than IDRs and includes unsponsored DRs. Nevertheless, the same arrangement as applicable for IDRs should continue. The depository should issue sponsored BhDRs with authorisation of the issuer of the underlying securities. It should issue unsponsored BhDRs in compliance with the process specified by SEBI. In either case, the substantive part of compliance with the regulations would rest with the depository. Therefore, it is necessary that the depository is a regulated intermediary in India.

4.14 Who may invest in BhDRs?

The Committee recommends that both Indian as well as foreign investors - retail as well as institutional - should be allowed to invest in BhDRs. While there should be no limit on investments in IDRs, the investments in BhDRs, other than IDRs, must be subject to the condition that their investments in foreign securities taken together and the DRs on the back of such foreign securities does not exceed the permissible limit. All investors - Indian or foreign - should be allowed to participate in the currency futures market to hedge the currency risk associated with their investment in BhDRs. Unsponsored BhDRs should be available only to sophisticated investors.

Sponsored issue:

The present laws permit persons resident in India as well as outside India to subscribe to IDRs.¹⁰⁷ Foreign Institutional Investors (FIIs), including SEBI approved sub-accounts of the FIIs, and non-resident Indians may purchase, hold or sell IDRs.¹⁰⁸ However, various institutional players face sectoral legal hurdles while investing in IDRs. For instance, insurance companies are prohibited under insurance laws from investing in IDRs since the proceeds are invested outside India.¹⁰⁹ The Committee is of the view that

¹⁰⁷ See Regulation 13, Reserve Bank of India, *FEMA 20*, see n. 43.

¹⁰⁸ FIIs and Non-resident Indians (NRIs) were not allowed to invest in IDRs till 2009. See Regulation 5(8) and Paragraph 2, Schedule 7, *ibid*.

¹⁰⁹ See section 27C, see n. 62; IRDA has issued a circular to CEOs of all insurers clarifying that section 27C of the Insurance Act, 1938 prohibits insurance companies from investing in IDRs since such

all institutional investors should be allowed a level playing field as far as investing in BhDRs is concerned. In fact, they must be allowed, enabled and encouraged to move to a prudent investors' regime, which is essential for growth of the economy.¹¹⁰

The Committee noted that investors in BhDRs may be exposed to foreign exchange risks because the underlying security is a foreign security denominated in a foreign currency. It is, therefore, necessary that such investors are allowed to hedge their foreign exchange risks by participating in the currency futures market. However, under the present laws, only persons resident in India are allowed to participate in the exchange traded currency futures market.¹¹¹ FIIs and NRIs are not permitted in this segment. The Committee recommends that all potential investors in the DR market should be allowed a level playing field in participating in the currency futures market.

The present law also requires that at least 50% of the IDRs issued must be allotted to QIBs. The remaining 50% may be allotted among other categories of non-institutional investors and retail investors, including employees, at the discretion of the issuer.¹¹² Moreover, the minimum application amount is Rs. 20,000.¹¹³ The Committee is of the view that these restrictions do not flow from the objective of consumer protection and should be removed for BhDRs.

Mr. G. Padmanabhan, Mr. S. Ravindran and Mr. M.S. Sahoo, members of the Committee, do not share the above view. According to them, the provisions regarding buckets for the different segments of investors may be in harmony with the norms for public issues in India. A minimum substantial percentage allotted to QIBs lends credibility to the issues and provides signals to the other non-institutional investors who usually take cues from the subscriptions made by QIBs. Mr. S. Ravindran further holds that, the requirement of minimum application amount of Rs.20,000 is in line with the amount of Rs.10,000-15,000 prescribed for public issues under *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*. This keeps out the very small investors for whom equity as an asset class may be disproportionately risky in comparison to their income. At the same time, it provides an opportunity for building a minimum portfolio value.

Un-sponsored issue:

An unsponsored BhDR can be established by a depository bank without any participation of the foreign issuer of the underlying security. In the event of fraud in the foreign issuer company, the possible remedies available to an Indian investor becomes crucial. Therefore, the Committee first examined the legal remedies available to unsponsored ADR holders in US.¹¹⁴

investment amounts to an indirect investment made outside the country. See, IRDA, see n. 62.

¹¹⁰See, Ministry of Finance, *Bajpai Committee*, see n. 65.

¹¹¹See, RBI, *Guidelines on trading of Currency Futures in Recognised Stock / New Exchanges*, A.P. (DIR Series) Circular No. 05, Aug. 6, 2008, URL: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=4410&Mode=0> (visited on 02/27/2014).

¹¹²See Regulations 98(d) and 98(e), SEBI, *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*, see n. 41.

¹¹³See Regulation 98(c), *ibid*.

¹¹⁴To further complicate matters, the U.S. Securities and Exchange Commission (SEC) passed a rule in 2008 that enables depository banks to issue ADRs without even obtaining consent from the foreign issuer, resulting in an explosion of the number of unsponsored ADRs. The depository bank, not the foreign issuer, must file a registration statement with the SEC, but it is not required to file periodic financial

In the US context, the SEC has civil enforcement authority under §10(b) of the *Securities Exchange Act, 1934* and the US Department of Justice (DOJ) has criminal enforcement authority.¹¹⁵ Further, injured investors can pursue a private right of action under §10(b). On June 24, 2010, the US Supreme Court in *Morrison* held that there is no ‘affirmative indication’ in the Exchange Act that §10(b) applies extraterritorially.¹¹⁶

The Congress promptly responded to the *Morrison* decision by adding §929P(b)(2) of Title IX of the *Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010*. It specifically provided the necessary affirmative indication of extraterritoriality for §10(b) actions brought by the SEC and DOJ, which involved transnational securities frauds.¹¹⁷

The reasoning in *Morrison* was that ‘only transactions in securities listed on domestic exchanges, and domestic transactions in other securities’ are covered by §10(b) of the *Securities Exchange Act, 1934*. In *Societe Generale*, the Federal District Court applied this reasoning and concluded that transactions in ADRs that do not trade over the facilities of registered US securities exchange, but only in the US OTC market, are not subject to the US anti-fraud provisions under *Morrison*.¹¹⁸ Some commentators have suggested that this decision may be based on the fact that ADRs traded OTC are often unsponsored and the issuer of the securities underlying the ADRs in those cases is completely uninvolved in the creation and trading of the ADRs in the United States.¹¹⁹

A foreign company that has issued underlying securities outside the US, on the back of which unsponsored ADRs are issued in the US, will not be liable under US anti-fraud laws. The reasons are:¹²⁰

- Such ADRs are not listed on a US stock exchange and therefore, do not satisfy the test in *Morrison*;
- The foreign corporations have not entered into a depository agreement with a US bank or directly solicited American investors;
- The foreign corporation raises no new capital through these unsponsored ADRs; and
- When purchasing these securities, investors know that the program is unsponsored. Consequently, investors assume the responsibility for the risks they take because these companies have neither arranged to offer these securities in the US nor have

data. Depository banks may issue unsponsored ADRs, however, for foreign issuers if they meet the Rule 12g3-2(b) requirements to be exempt from the application and reporting process with the SEC. Rule 12g3-2(b) has several conditions, the most important of which is that the foreign issuer publishes financial statements in English on its website. In short, many large foreign companies inadvertently, and perhaps unknowingly, qualify for this exemption, thereby enabling depository banks to cross-list them in the US via unsponsored ADRs. See, Grant Swanson, “A comparative analysis of private securities litigation in the wake of *Morrison v. National Australia Bank*”, in: *Chicago-Kent Law Review* (2012), p. 965.

¹¹⁵ §10(b) of the *Securities Exchange Act, 1934* is the anti-fraud provision in US securities laws.

¹¹⁶ Supreme Court of United States of America, *Rober Morrison v. National Australia Bank Ltd.* 561 U.S. 247.

¹¹⁷ See, Securities and Exchange Commission, *Study on the Cross-Border Scope of the Private Right of Action Under Section 10(b) of the Securities Exchange Act of 1934*, tech. rep., Apr. 2012.

¹¹⁸ See, United States District Court for the Southern District of New York, *In re Societe Generale Securities Litigation*, 2010 U.S. Dist. LEXIS 107719.

¹¹⁹ See, Hannah L. Buxbaum, “Access to justice: Investors suits in the era of the Robert Court: Remedies for foreign investors under US Federal securities law”, in: *Law and Contemporary Problems* (2012), p. 161.

¹²⁰ See, Vincent M. Chiappini, “How American are American depository receipts? ADRs, Rule 10b-5 suits, and *Morrison v. National Australia Bank*”, in: *Boston College Law Review* (2011), p. 1795.

they submitted to regulation by the SEC.

The Committee noted that in the Indian context, the *SEBI Act, 1992* and the *Companies Act, 2013* do not make explicit provisions for extraterritorial application. Therefore, it may be argued that Indian investors in unsponsored BhDRs would not be able to seek remedy in Indian courts under the *SEBI Act, 1992* in the event of a fraud by the management of the company incorporated outside India, which has not authorised the issuance of such BhDRs. The Committee does not subscribe to this view, as explained in Chapter 4.17. Nevertheless, it notes that the remedy may be a lengthy process as the issuer has not submitted to the Indian jurisdiction, and, therefore, recommends that only sophisticated investors should be allowed to invest in unsponsored BhDRs and that retail investors must not be allowed to invest in these instruments.

4.15 How to deal with conflict in provisions in two jurisdictions?

The Committee recommends that SEBI should clearly specify what provisions in the Indian jurisdiction will override provisions of foreign jurisdictions.

The issuance, listing and trading of BhDRs in India would require compliance with Indian laws. However, the issuer of the securities underlying the BhDRs needs to comply with the provisions in the home jurisdiction and possibly other foreign jurisdictions. In such cases, it is possible that the provisions may be inconsistent with one another and the issuer, if it complies with the requirements of home jurisdiction, would not be able to comply with the requirements of the Indian jurisdiction occasionally. The Committee recommends that SEBI should address this issue in its regulations and specify clearly which Indian provisions will have overriding effect over the provisions in foreign jurisdictions.

4.16 Should trading of foreign DRs be permitted?

The Committee recommends trading of foreign DRs in India.

A review of foreign jurisdictions in Chapter 2.5 indicates that several global financial hubs allow trading in foreign-issued DRs on local exchanges. For example, the SGX allowed trading of ADRs on its GlobeQuote board from 2010 in co-operation with NASDAQ. The Committee is of the view that India can also become a hub for trading ADRs and GDRs in addition to BhDRs. The possibilities of market failure in the former is no different than that posed due to trading of BhDRs. Therefore, the Committee is of the view that trading of foreign DRs should be permitted in India. However, such DRs like unsponsored BhDRs should be available to sophisticated investors.

4.17 Can SEBI deal with market abuse?

The Committee recommends that the SEBI Act, 1992 be amended to clarify extraterritorial application of section 12A over market abuses abroad which may have negative implications for BhDRs investors in India. This is to make explicit what has been

implicit so far.

The DR market is intricately connected to the market of the underlying security because of fungibility.¹²¹ Therefore, any market abuse in one can have a detrimental effect on the other. In case of BhDRs, any market abuse in the underlying foreign securities will detrimentally affect Indian investors of such BhDRs. This Committee has in a previous report concluded that SEBI will have jurisdiction over any instance of market abuse using DRs abroad having an effect on the Indian securities market.¹²² This was in view of the ‘structured DR transactions’ unearthed by SEBI, as was discussed in the earlier report. In these transactions, a leg of the transaction was always in India, allowing SEBI to exercise jurisdiction under section 12A of the *SEBI Act, 1992*. However, in case of BhDRs, any market abuse in relation to the foreign underlying security committed abroad will have an effect on the Indian BhDR market. Unlike ‘structured DR transactions’, these market abuses may not have an Indian connection. A doubt therefore arises as to whether section 12A would adequately deal with such market abuses.

The power of the Parliament to enact laws having extraterritorial operation was recently considered by a Constitution Bench of the Supreme Court of India in *GVK Industries*.¹²³ The Supreme Court, in *GVK Industries* held that the Parliament’s powers to make laws having an extraterritorial operation is circumscribed by Article 245(1) that allows the Parliament to make laws “for the whole or any part of the territory of India.” The Court applied the principle of *expression unius est exclusion alterius* to hold that the express mention of one thing (i.e. Parliament has powers to make laws for the whole or any part of the territory of India) implies the exclusion of another (i.e. the power to make laws with respect for another territory). Thus, the law so made by the Parliament must have some territorial nexus. Whether a particular law enacted by the Parliament does have a real connection or an expected real connection between the extraterritorial aspect or cause on the one hand, and something in India or related to India or Indians on the other, is a mixed question of fact and of law. The Supreme Court in *GVK Industries* has held that the Parliament may exercise its legislative powers with respect to extra-territorial aspects or causes only when such extraterritorial aspects or cases have, or are expected to have some impacts on, or effects in, or consequences for the territory of India, or any part of India or the interests of, welfare of, well-being of, or security of the inhabitants of India. In *Republic of Italy v. Union of India*, where the question of whether the Republic of India had jurisdiction over persons who committed a criminal offence beyond the territorial waters of India, Chalmeshwar J. held that extraterritorial application of Indian criminal law was valid as India’s “legitimate interests” were affected.

In view of the above, the *SEBI Act, 1992* clearly entails powers for SEBI to issue directions and investigate market abuse in the territory of India. If a person outside India were to indulge in conduct that has an effect or impact on the Indian securities market, SEBI would have jurisdiction to act against that person’s involvement in the Indian

¹²¹ See Chapter 4.17, M.S. Sahoo, see n. 9.

¹²² See Chapter 4.17, *ibid*.

¹²³ See, Supreme Court of India, *GVK Industries Ltd. v. Income Tax Officer*, (2011) 4 Supreme Court Cases 36.

territorial market. The law would not become inapplicable merely because the person is outside India. In fact, SEBI has asserted this power and taken action, though a particular matter is now in the Supreme Court. Nevertheless, to put the matter beyond doubt, it is desirable to amend the *SEBI Act, 1992* to clarify that the provision of the *SEBI Act, 1992* have application over entities located outside India if their activities are affecting the securities markets in India. This would make explicit what has been implicit so far.

4.18 How should the BhDRs be taxed?

The Committee recommends that the issue or deposit of underlying foreign securities to/with an Indian depository and the corresponding issue of BhDRs to investors in India should not attract any tax. The conversion of BhDRs into underlying foreign securities, except for the conversion by a non-resident person, and vice versa should also not attract tax. The taxation regime applicable to transactions in comparable domestic securities should apply to transactions in BhDRs. The returns on BhDRs should be taxed as if such income arose directly from the underlying foreign securities.

The Committee notes that issue and trading of BhDRs in India, as envisaged in this report, involve the following activities:

1. Issue or deposit of underlying securities by a foreign issuer or holders of such securities, as the case may be, to/with an Indian depository;
2. Issue of BhDRs by the domestic depository to investors in India on the back of underlying foreign securities;
3. Conversion of BhDRs into underlying foreign securities;
4. Conversion of underlying foreign securities into BhDRs;
5. Sale of underlying foreign securities after conversion from BhDRs;
6. Transfer of BhDRs through transactions in India on or outside stock exchanges; and
7. Returns (dividend, interest or any other income, as the case may be) paid by the foreign issuer to Indian depository and subsequent transfer of the same by the depository to investors in BhDRs in India.

The basic principle of taxation is that only gains, profits or income are taxed. These usually arise either on transfer of an asset or on accrual of income on the asset. The activities at (1) and (2) are creation of securities and not transfer. Such activities, whether in India or outside India, do not attract any tax. This is similar to issue of underlying securities in India and issue of ADRs on back of such securities overseas.

The BhDRs and the underlying securities are one and the same asset, though in law these are two different forms of securities. The activities listed at (3) and (4) above do not involve transfer of assets, but conversion from one form to another without any change in beneficial ownership. This is akin to transfer of registered ownership (not beneficial ownership) by conversion from physical securities to demat securities under the *Depositories Act, 1996*. This is also akin to transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company under section 47(x) of the *Income Tax Act, 1961*. Therefore, the activities at (3) and (4) are not transfers and should not be taxable activities. Section 47(x), which applies to ADRs/GDRs, can apply to any depository receipts -

IDRs or ADRs - which are convertible into shares or debentures of that company. Since the Committee envisages BhDRs, which are convertible into any kind of underlying securities of any issuer, section 47(x) may be amended suitably to exempt conversion of BhDRs into underlying foreign securities from the ambit of transfer, subject to the exception noted in the following paragraph.

When underlying foreign securities after conversion from BhDRs are eventually sold, that is, the activity at (5) above, the investor would be liable to tax as per the tax laws. The period of holding should be aggregate of the period when the BhDRs was held and the period when the underlying securities was held thereafter. For computing the taxable gain, the cost of acquisition should be the cost at which the BhDRs was acquired by the investor and the gain would be computed as the excess of the sale consideration for the underlying foreign securities over the cost of acquisition of the BhDRs. Thus, the investor would be taxed on the BhDRs or the underlying as if she had invested in the underlying foreign securities directly for the entire period. This will hold good for resident persons.

This has potential to provide tax arbitrage to a non-resident. For example, a non-resident may buy BhDRs and holds these till prices appreciate and then converts these to the underlying and sells the underlying abroad. Therefore, the conversion of the BhDRs into foreign securities by a non-resident investor, that is activity (3) above, should be regarded as a taxable event. For the purpose of determining the gain, two possible approaches could be considered -

1. to deem the price at which the BhDRs is trading in the Indian markets on the date of conversion as the sale consideration received by the BhDRs holder, or
2. deem the price at which the underlying foreign security is trading in its home market on the date of conversion as the sale consideration received by the BhDRs holder.

It would be easier for the investor as well as the administration to verify the tax computation if option (1) is adopted. However, if the international price of the underlying is higher than the price at which the BhDR is being traded on an Indian exchange, the difference would escape Indian taxation. On balance, we would have to pick the option that is practical and easier to implement and administer. If that were to mean that India may potentially lose some amount of tax revenues, so be it; this must be weighed against the benefit of having foreign investors trade on Indian exchanges. In view of the above, the Committee recommends differential tax treatment for resident investors and non-resident investors in respect of the activities at (3) and (5) above. Activities (3) and (5) are taxable events for non-resident investor and resident investors respectively.

The activity at (6) above involves transfer of asset from one person to another though there is no transfer of the underlying securities. There are two possible approaches to tax this activity – either at par with comparable Indian securities or at par with the underlying foreign securities. As stated elsewhere, DRs, being rights or interests in securities, are securities in India. The taxation regime applicable to transfer of securities in India should be applicable to transfer of BhDRs. That is, if transactions in equity on stock exchanges attract Securities Transaction Tax (STT), transactions in BhDRs with equity as underlying on stock exchange should also attract STTs. By the same analogy, the off-stock exchange transactions should be taxable in India as any other capital asset or business income, as the case may be. If the taxation regime treats domestic debt

and equity instruments differentially, it should extend the same differential treatment to BhDRs with underlying of equity or debt, as the case may be. The other approach is that the taxation regime should be neutral to various forms of the same asset for an Indian investor. That is, she should face similar tax treatment whether she deals in the underlying foreign securities or BhDRs based on such underlying securities. Since the BhDRs are domestic securities and transactions would happen in India, while there is no market for underlying foreign securities in India, the Committee recommends the first approach.

Mr. Sunil Gupta, a member of the Committee, is of the view that transactions of listed shares of an Indian company are subject to STT at nominal rate and consequently such transaction have preferential capital gains tax regime i.e. long term capital gains are exempt and short term gains are taxable at the lower rate of 15%. The preferential tax regime has been provided as a tax subsidy so that Indian companies can raise low cost funds by way of equity. He has therefore suggested that the preferential tax regime on transactions in BhDRs with underlying equity shares of foreign companies may not be provided.

Activity at (7) above results in an income for the investor. India used to have a regime where investor used to pay tax on returns, dividend or interest, as the case may be, at applicable rates. It has now moved to a regime, where the issuer being a domestic company pays Dividend Distribution Tax (DDT) while distributing dividend and the investor does not have to pay any tax further. It is not that DDT reduces the tax liability on the investor - it could be higher or lower depending on the rate of DDT. It is only a matter of convenience that the issuer pays DDT, but it pays practically on behalf of and out of the dues to the investor. If the BhDR has equity as underlying, the issuer is outside jurisdiction of India and is not amenable to Indian taxation regime. Thus, no income would accrue to the exchequer when a foreign issuer distributes dividend to a domestic depository. Therefore, DDT approach is not feasible. A possible way out could be that by a legal fiction, the Indian depository is considered as the disbursing of returns to Indian investors and depending on the nature of the asset on which return is disbursed, Indian taxation regime may apply. This would work regardless of:

1. whether the issue is a sponsored or unsponsored one, and
2. the nature of underlying and consequently the nature of income.

Under this approach, the investor would be liable to pay tax on returns as if such returns have arisen from the underlying foreign securities. The tax could be levied on the depositories for the sake of administrative convenience. Or, the domestic depository would deduct tax at source from income distributions to the investors at the rate prescribed under the Act.

Where return by way of dividend or interest is paid by the foreign company in respect of underlying securities of BhDRs, a tax is normally withheld in the home jurisdiction of the foreign company. This foreign tax is creditable in the hands of the recipient of income in India. If the tax on such income is paid by the Indian depository, then, it would be entitled to foreign tax credit and the same can be given easily as the depository would be the registered person with the foreign company. However, if the Indian Depository is treated as a trustee of such income on behalf of the investors in BhDRs, then the tax would be payable by the investors. Though such investors (only residents) would be entitled to foreign tax credit, it would create practical difficulties for tax administration

to grant such foreign tax credit as the foreign tax is withheld in the name of the Indian Depository. In order to avoid practical problems, a simple mechanism needs to be developed in tax rules for granting foreign tax credit to investors in BhDRs in India.

The activities at (6) and (7) attract tax. However, the rate of tax depends on the nature of comparable domestic securities or the underlying foreign securities. If a BhDR is issued on the back of a basket of underlying securities of different nature, it would be difficult to tax transactions in or returns on such a BhDR, as there is no tax rate prescribed in the Act for the basket of comparable domestic securities or underlying foreign securities. It becomes further difficult if BhDR are issued on the back of different baskets of securities which combine different securities in different proportions. It is, therefore, necessary that a BhDR may be issued on a particular security, i.e., a BhDR can be issued on a class of equity shares of a company, and another BhDR can be issued on a class of debt securities of the company, and no BhDR should be issued on a combination of two classes of securities of the company. Hybrid BhDRs could be considered at a later stage.

The Committee noted that the activities at (6) and (7) above pose challenges because different countries treat these transactions differently. All countries do not levy STT or DDT and those who do, do not have the same rate or the basis of taxation. Hence it is not possible to ensure horizontal parity. We should be happy if we can ensure the BhDRs which are securities in India are treated at par with other similar securities in India. However, the problem would be addressed when the developed financial markets move towards residence based taxation, the early signs of which are already available.

4.19 Which authority/ law should govern issue/ trading of BhDRs?

The Committee recommends that SEBI should be the sole regulator of market for BhDRs as it is responsible for protection of investors in securities and only market failure associated with BhDRs is consumer protection

Presently, the *Companies Act, 2013* and the rules made thereunder and the *SEBI Act, 1992* and the regulations made thereunder contain provisions for issue and trading of IDRs. The SEBI framework revolves around the IDRs permitted under the company law. It does not envisage or allow other kinds of DRs. This has happened for historical reasons. Most of the provisions in the Rules under the company law are intended for investor protection and can as well form part of SEBI regulations. It does not serve any purpose to make some provisions about DRs under the company law and some others under the securities laws. Rather it prevents growth of the market for DRs others than IDRs and carries the possibility of regulatory inconsistency and duplication. SEBI is the regulator of the securities market and has the responsibility of protection of investors in securities. It understands the needs of the Indian investors and Indian financial system much better. BhDRs is another competing security in the securities market. In any case, the company law has no provision to deal with BhDRs, other than IDRs. Therefore, SEBI is better equipped legally and professionally to regulate the market for BhDRs.

Foreign jurisdictions have chosen to consolidate responsibility for regulation of DRs under their local securities regulators. In the case of the US, this has allowed their regulator to develop the expertise and authority necessary to regulate a large and

complex market.

Keeping the above in view, the Committee recommends that the market for BhDRs be regulated by SEBI. However, this market would meet the requirements of capital control regime as may be enunciated by RBI from time to time. This would also comply with all other applicable laws such as *Income Tax Act, 1961*. The governing framework for DRs should be specified through regulations only.

4.20 Is approval necessary for issue of BhDRs?

The Committee recommends that no specific approval should be necessary for issue or creation of BhDRs on the back of foreign securities. However, it does not recommend dispensing with any approval that may be required under the Foreign Exchange Management Act, 1999.

The extant regime requires the issuer of IDRs to obtain necessary approvals or exemptions from the authorities of the home country. It also requires the issuer to obtain prior written approval from SEBI on an application made in this behalf. India along with the rest of world has moved away from the requirement of approval for any issue of capital from any authority. India made a clear departure from merit based regulation when it repealed the *Capital Issues (Control) Act, 1947* in 1992 and established SEBI to usher in a disclosure based regulatory regime. The requirement of approval for an issue of capital takes the country back by two decades to merit based regulatory regime. The Committee, therefore, recommends the same process of issue and trading of BhDRs as any issue or trading of any other security under the securities laws.

5 — Recommendations

This chapter summarises the principles guiding the recommendations of the Committee and its recommendations based on the same. It uses the relevant recommendations to draft Bharat Depository Guidelines, 2014 which would guide SEBI, RBI and the Central Government to make appropriate provisions in respective laws and regulations.

5.1 Principles

The principles guiding recommendations of the Committee are as under:

1. The recommendations are circumscribed by the capital control regime in vogue in India. Without seeking any change in the said regime, the Committee has attempted to reform the framework of domestic depository receipts (DRs), though it believes that the capital control regime presents ample scope and need for reforms. The domestic DR mechanism now proposed has built-in flexibility to hold good under any level of capital control regime.
2. Within the extant capital control regime, the Indian market must offer a complete suite of services as available in an International Financial Centre and must be internationally competitive.
3. Indian investors, foreign investors, foreign firms, and Indian firms must have full freedom to access financial services, including capital, within the prevalent capital control regime in India. The State should be agnostic if an Indian investor invests in securities of a foreign firm directly or through DRs issued on the back of such securities. Similarly, a foreign firm may raise resources from Indian investors directly or through issue of DRs in India. The economic agents must have full freedom to decide the mode of investment or raising resources.
4. There should not be any intervention that can distort the freedom of choice of Indian firms, Indian investors, foreign firms and foreign investors unless there is likelihood or evidence of market failure. The only market failure associated with domestic DRs is consumer protection and the regulator must design regulations keeping investor protection in view.

5. The DR mode should not suffer from any additional restriction or enjoy any privilege as compared to any other mode. The State must neither promote nor discourage issuance and/or trading of DRs in India.
6. In a reciprocal world, a country is treated the same way as it treats other countries. Indian issuers and investors would receive the same treatment overseas as India treats overseas issuers and investors in India. It should, therefore, offer a domestic DR framework which is commensurate with its ADR/GDR framework and is competitive vis-a-vis depository frameworks overseas. This would ensure import of as much of capital markets as it exports and would match the pressure of inflows by facilitating outflows.
7. The domestic DR are just another security. The regulatory framework applicable to securities should *mutatis mutandis* apply to issuance or trading of such receipts. For example, if no approval is required for issuance of equities in India, there should be no approval required for issuance of DRs on the back of foreign equities.
8. The taxation regime should be neutral between transactions in BhDRs and transactions in comparable domestic securities. It should also be neutral between the incomes on BhDRs and incomes on foreign underlying securities.
9. The market for DRs and the market for their underlying securities are connected and, therefore, the concerns of market abuse and money laundering in one market impinging on the other are real and need to be addressed.
10. Every market needs an empowered regulator. The regulation of the market for DRs must be assigned to one, only one, but adequately empowered, regulator.

5.2 Recommendations

The Committee recommends as under:

1. If a particular foreign security is accessible to an Indian investor under the extant capital control regime, the DRs on the back of such security should also be available to her. If for any reason a particular foreign security is made inaccessible to Indian investors at any time, fresh DRs on that foreign security shall cease to be available.
2. The Committee refers to the set of foreign securities accessible to Indian investors under the capital control regime as ‘permissible securities’. It refers to the DRs on the back of such permissible securities as “Bharat Depository Receipts (BhDRs)”. The set of permissible securities would change from time to time and hence the BhDRs would be available on a floating set of permissible securities. It recommends BhDRs in contrast to IDRs as available now. BhDRs are issued on the back of permissible securities — debt or equity — issued by a company or otherwise, with or without authorisation of the issuer. IDRs are issued on the back of equities of a foreign company with the authorisation of the issuer. IDRs are a sub-set of BhDRs.
3. A complete suite of BhDRs should be allowed to be issued and traded in India to make the Indian financial system more competitive, and to provide greater choice to Indian investors. The Indian market should allow trading of DRs issued or listed elsewhere, in addition to BhDRs. Nevertheless, the Indian State must not promote or discourage issuance or trading of BhDRs or foreign DRs.

4. The IDRs are ‘securities’ under the Indian law and hence protection available to and against securities should be available to investors in IDRs. However, all BhDRs may not be securities. Therefore, the Central Government should notify BhDRs as ‘securities’ under the *Securities Contracts (Regulation) Act, 1956*. This would give complete authority to SEBI to regulate the market for BhDRs and comparable investor protection framework applicable to domestic securities shall apply to BhDRs.
5. SEBI should be exclusive regulator for the market for securities, including BhDRs, as it is responsible for protection of investors in securities and only market failure associated with BhDRs is consumer protection. This would avoid inconsistency or duplicity of regulations and shifting of responsibilities. Further, SEBI should use only one instrument of subordinate legislation to regulate issuance and trading of BhDRs.
6. The issuance or trading of BhDRs in India needs to be regulated to the extent necessary to protect Indian investors in such instruments and to harmonise the DR related transactions to the extant capital controls regime.
7. There may be multiple levels of BhDRs suiting different classes of investors and such levels of BhDRs may have different regulatory and compliance requirements. SEBI should create, at a minimum, two ‘levels’ of BhDRs: Level-I should be restricted to sophisticated investors and Level-II should be available for all investors, including retail Indian investors. The issuers accessing the Indian market through Level-I framework should have a lower regulatory burden but can access only sophisticated investors by having a million rupee market lot. However, SEBI may use different criteria to indicate the level of sophistication of an investor. The issuers using the Level-II framework must be given the same treatment as is given to an Indian issuer of securities that are accessible to all Indian investors. In contrast to the current approach of ‘one-size-fits-all’, market should offer a variety of BhDRs that would match profiles of different classes of investors.
8. The BhDRs may be issued only on those underlying foreign securities which are listed on an international exchange which is accessible to the public for trading and provides pre-trade and post-trade transparency to the public. This would ensure protection through initial and continuous disclosures. Such underlying securities must also be in demat form to facilitate gathering of data particularly about the headroom available for fungibility. The BhDRs must be listed in India.
9. The investors in BhDRs need to be protected from market abuse as well as corporate frauds. The Indian market needs to be protected from money laundering. Keeping in mind these concerns, the Committee recommends that the issuer of the underlying foreign security must be from a ‘permissible jurisdiction’ which is under legal obligations to share information and cooperate with the Indian authorities in the event of any investigation, that is, it must be FATF and IOSCO compliant. The foreign issuer should not be suffering from any debarment from accessing capital markets.
10. The BhDRs could be issued for both capital raising or non-capital raising purposes. These could be sponsored or unsponsored. Any foreign issuer who is not debarred should be able to issue fresh securities on the back of which BhDRs may be issued in India by a domestic depository. Any person holding listed securities issued by

foreign issuers should be able to transfer those securities which may be deposited with a foreign custodian and on the back of such securities, BhDRs may be issued in India by a domestic depository.

11. The proceeds from BhDR issues may be repatriated or used within India and no end use restrictions must be imposed as long as it is serving the domestic real economy.
12. The issue size of BhDRs should be restricted to 25% of the class of listed underlying foreign securities.
13. Two-way fungibility should be allowed to the extent of the aggregate size of the BhDR issues, not the size of the original issuance. This helps in arbitrage and consequently in maintaining the law of one price between the DR and its underlying securities, in addition to providing an additional exit opportunity to BhDR holders. The pricing of BhDRs should not be regulated.
14. The Indian law should be neutral to the presence or absence of voting rights in favour of BhDR holders.
15. A regulated entity which has permission to perform the role of a securities custodian under the laws of a permissible jurisdiction may act as a foreign custodian for the underlying securities.
16. A domestic depository specifically having permission to carry on the business of issuing BhDRs may issue BhDRs in India. Such a depository shall have an obligation to comply with the provisions relating to issuance and trading of BhDRs.
17. Both Indian – retail and institutional – as well as foreign investors should be allowed to invest in BhDRs. The institutional investors must be allowed, enabled and encouraged to move to the prudent investors' regime.
18. Foreign investors in BhDRs should be allowed to participate in the currency futures market to hedge the currency risk associated with their investment in BhDRs.
19. While there should be no limit on investments by Indian investors in IDRs, as is the norm now, their investments in BhDRs, other than IDRs, must be subject to the condition that their investments in foreign securities and the DRs on the back of such foreign securities taken together do not exceed the permissible limit under the capital control regime in vogue.
20. The requirement of minimum subscription by QIBs and minimum application amount of Rs.20,000 should be removed.
21. Since the issuers of the securities underlying unsponsored BhDRs as well as issuers of foreign DRs do not submit to the jurisdiction of Indian authorities, the remedy available to investors in the event of a fraud by the issuer may be tedious. Therefore, only sophisticated investors should be allowed to invest in unsponsored BhDRs and foreign DRs.
22. SEBI should clearly specify what provisions of Indian jurisdiction will have overriding effect over provisions of foreign jurisdictions.
23. The *SEBI Act, 1992* may be amended to clarify extraterritorial application of section 12A over market abuses abroad which may have negative implications for BhDRs investors in India.
24. The issuance or deposit of underlying permissible securities to/with an Indian depository, issuance of BhDRs in India, conversion of BhDRs into underlying

securities and vice versa should not attract any tax. The taxation regime applicable to transactions in comparable domestic securities should apply to transactions in BhDRs. The returns on BhDRs should be taxed as if such income arose directly from the underlying foreign securities. Hybrid BhDRs (that is, DRs on a basket of different classes of securities) should be avoided for the present.

25. No specific approval should be necessary for issuance or creation of BhDRs on the back of foreign securities. However, any approval that may be required under the *Foreign Exchange Management Act, 1999* may not be dispensed with.
26. When the aggregate market value of outstanding BhDRs, excluding IDRs, reaches a threshold, the BhDR framework should be reviewed.

5.3 Bharat Depository Receipts Guidelines

Keeping the above in view, the Committee has attempted to draft guidelines to serve as guidelines for SEBI to make regulations for issuance and trading of BhDRs. The draft guidelines are at Annexure C. A comparative picture of the extant IDR framework vis-à-vis the proposed BhDR framework is presented in Table 5.1.

Table 5.1: Comparison of existing and proposed frameworks

Sl No.	Parameter	Extant Framework	Proposed framework for BhDRs
1.	Instrument	Indian depository receipts (IDRs)	Bharat depository receipts, including IDRs
2.	Instrument of subordinate legislation	Rules, regulations, circulars, guidelines	Regulations
3.	Level of instrument	One level	Multiple levels
4.	Underlying securities	Equities of foreign companies	All securities accessible to Indian investors under the capital control regime in vogue
5.	Listing of underlying	Listing in home jurisdiction	Listing on an international exchange in FATF/IOSCO compliant jurisdiction
6.	Listing of instrument	On a recognised stock exchange	On a recognised stock exchange
7.	Location of issuer of underlying	Any foreign jurisdiction	FATF and IOSCO compliant jurisdiction
8.	Purpose of issue	Capital raising	Both capital raising and non-capital raising

Table 5.1: Comparison of existing and proposed frameworks

Sl No.	Parameter	Extant Framework	Proposed framework for BhDRs
9.	Kind of issue	Sponsored	Both sponsored and unsponsored
10.	Size of issue	15% of underlying size	25% of underlying size
11.	End use restriction	Compulsory repatriation	Can be used in India also
12.	Fungibility	Not within the first year and up to 25% thereafter	Full fungibility from day one
13.	Who can invest	Retail, some institutions	a. IDR: Retail, Institutions; b. BhDRs (other than IDRs): Those permitted under capital controls regime c. Unsponsored BhDRs: Sophisticated investors d. Foreign DRs: Sophisticated investors e. Level I BhDRs: Sophisticated investors f. Level II BhDRs: All investors
14.	Tax	No clarity	a. Clear provision b. Transactions at par with comparable domestic securities c. Returns at par with underlying foreign securities
15.	Approval	Required from SEBI	No approval
16.	Trading of overseas DRs	Not permitted	Permitted
17.	Regulator	MCA and SEBI	SEBI with explicit extraterritorial jurisdiction
18.	Review	No review	Review after value of outstanding BhDRs (excluding IDRs) reach a threshold

Bibliography

Articles

- Abdallah, Abed Al-Nasser and Christos Ioannidis, “Why do firms cross-list? International evidence from the US market”, in: *Quarterly Review of Economics and Finance* 5 (2010), pp. 202–213.
- Benos, Evangelos and Michael S. Weisbach, “Private benefits and cross-listings in the United States”, in: *Emerging Markets Review* 5 (2004), pp. 217–240.
- Buxbaum, Hannah L., “Access to justice: Investors suits in the era of the Robert Court: Remedies for foreign investors under US Federal securities law”, in: *Law and Contemporary Problems* (2012), p. 161.
- Chiappini, Vincent M., “How American are American depository receipts? ADRs, Rule 10b-5 suits, and Morrison v. National Australia Bank”, in: *Boston College Law Review* (2011), p. 1795.
- Coffee Jr., John C., “Racing Towards the Top: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance”, in: *Columbia Law Review* 102 (2002).
- Davis Jr., Kenneth B., “The SEC and Foreign Companies - A Balance of Competing Interests”, in: *University of Pittsburgh Law Review* 71.3 (2009).
- Karolyi, G. Andrew, “Why do Companies List Shares Abroad?: A Survey of the Evidence and Its Managerial Implications”, in: *Financial Markets, Institutions and Instruments* 7 (1998).
- Sahoo, M.S., “Historical perspective of securities laws”, in: *NSE News* (Feb. 2005).
- Saunders, Mark, “American Depository Receipts: An Introduction to U.S. Capital Markets for Foreign Companies”, in: *Fordham International Law Journal* 17 (1993).

Shukla, Aditya, Ruchi Biyani, and Vyapak Desai, “Indian depository receipts: Limited two-way fungibility allowed”, in: *Nishith Desai Associates Corpsec Hotline* (Sept. 10, 2012), URL: http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/indian-depository-receipt-limited-two-way-fungibility-allowed.html?no_cache=1&cHash=9f94efeb3eb8a69909521692333179ee (visited on 02/04/2014).

Stigler, Matthew, Ajay Shah, and Ila Patnaik, “Understanding the ADR premium under market segmentation”, in: *NIPFP Working Paper Series* (July 29, 2010), URL: http://www.nipfp.org.in/media/medialibrary/2013/04/wp_2010_71.pdf.

Swanson, Grant, “A comparative analysis of private securities litigation in the wake of *Morrison v. National Australia Bank*”, in: *Chicago-Kent Law Review* (2012), p. 965.

Reports

B.N. Srikrishna, *Report of the Financial Sector Legislative Reforms Commission*, tech. rep., Government of India, 2013.

BOVESPA, *Brazilian Depositary Receipts*, tech. rep., BOVESPA, 2001, URL: www.bovespa.com.br/pdf/bdr_i_20122001.pdf (visited on 02/02/2014).

Committee on Capital Markets Regulation, *Competitiveness Measures*, tech. rep., Committee on Capital Markets Regulation, Dec. 31, 2012, URL: <http://capmksreg.org/education-research/competitiveness-measures/> (visited on 02/02/2014).

Jamshed J. Irani, *Report on Company Law*, tech. rep., Ministry of Company Affairs, 2005.

Ministry of Finance, *Report of the Committee on Investment Norms for Insurance and Pension Funds*, tech. rep., 2013.

— *Speech of Pranab Mukherjee*, tech. rep., Mar. 16, 2012, URL: <http://indiabudget.nic.in/ub2012-13/bs/bs.pdf> (visited on 02/02/2014).

M.S. Sahoo, *Report of the committee to review the FCCBs and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993*, tech. rep., Ministry of Finance, Nov. 26, 2013.

Percy Mistry, *Report of the High Powered Expert Committee on Making Mumbai an International Financial Centre*, tech. rep., Feb. 10, 2007.

Raghuram Rajan, *Hundred small steps: Report of the Committee on Financial Sector Reforms*, tech. rep., Planning Commission of India, Sept. 12, 2008.

Securities and Exchange Commission, *Study on the Cross-Border Scope of the Private Right of Action Under Section 10(b) of the Securities Exchange Act of 1934*, tech. rep., Apr. 2012.

Standing Committee on Finance, *The Companies Bill, 2009: Twenty-first Report*, tech. rep., Lok Sabha, Aug. 31, 2010.

U.K. Sinha, *Report of the Working Group on Foreign Investment*, tech. rep., Department of Economic Affairs, Ministry of Finance, July 30, 2010.

Laws

Capital Issues (Control) Act, 1947.

Companies Act, 1956.

Companies Act, 2013.

Companies (Amendment) Act, 2000.

Depositories Act, 1996.

Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [Official Journal L 145 of 30.4.2004].

Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010.

Financial Services and Markets Act 2000.

Foreign Exchange Management Act, 1999.

Income Tax Act, 1961.

Insurance Act, 1938.

IRDA, *Indian Depository Receipts*, IRDA/INV/CIR/015/June 09, June 4, 2009.

Ministry of Corporate Affairs, *Companies (Issue of Indian Depository Receipts) Rules, 2004*, Notification number GSR 131(E) dated 23rd February 2004.

— *Companies (Registration of Foreign Companies) Rules, 2014*, 2014.

— *Notification*, File No. 1/15/2013-CL.V, Mar. 26, 2014.

Monetary Authority of Singapore, *Mainboard Rules*, Sept. 29, 2011.

Pension Fund Regulatory and Development Authority Act, 2013.

RBI, *Guidelines on trading of Currency Futures in Recognised Stock / New Exchanges*, A.P. (DIR Series) Circular No. 05, Aug. 6, 2008, URL: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=4410&Mode=0> (visited on 02/27/2014).

— *Liberalised Remittance Scheme (LRS) for resident individuals-Increase in the limit from USD 75,000 to USD 125,000*, A.P. (DIR Series) Circular No.138, June 3, 2014, URL: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=8918&Mode=0> (visited on 06/05/2014).

— *Master Circular on Foreign Investment in India*, July 1, 2013.

— *Master Circular on Foreign Investment in India*, Master Circular No. 15/2013-14, July 1, 2013.

RBI, *Master Circular on Loans and Advances*, DBOD.No.Dir.BC.14/13.03.00/2013-14, July 1, 2013.

Regulation D, URL: <http://www.ecfr.gov/cgi-bin/text-idx?SID=c596b30776eed01dfc0b2d2e58&node=17:3.0.1.1.12.0.46&rgn=div7>.

Reserve Bank of India, *Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2004*, Notification No. FEMA 120/2004-RB dated 7-7-2004, July 7, 2004.

— *Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000*, Notification No. FEMA 20/2000-RB dated 3rd May 2000, May 17, 2000.

— *Issue of Indian Depository Receipts*, July 22, 2009.

SEBI, *Guidelines for Enabling Partial Two-Way Fungibility of Indian Depository Receipts*, CIR/CFD/DIL/6/2013, Mar. 1, 2013, URL: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1362136042656.pdf (visited on 06/01/2014).

— *Redemption of Indian Depository Receipts into underlying equity shares*, CIR/CFD/DIL/10/2012, Aug. 28, 2012, URL: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1346153584231.pdf (visited on 06/01/2014).

— *SEBI (Disclosure and Investor Protection) Guidelines, 2000*, 2000.

— *SEBI (Framework for rejection of draft offer documents) Order, 2012*, General Order No. 1 of 2012, Oct. 9, 2012, URL: <http://www.sebi.gov.in/sebiweb/home/list/1/4/0/0/General-Orders> (visited on 06/01/2014).

— *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009*, 2009.

SEBI Act, 1992.

Securities and Exchange Commission, *General Rules and Regulations, Securities Act of 1933*, 17 CFR 230.114A, 1933.

Securities Contracts (Regulation) Act, 1956.

Securities Exchange Act, 1934.

Annexure-A1

**F.No.9/1/ 2013-ECB
MINISTRY OF FINANCE
Department of Economic Affairs
(Capital Markets Division)**

North Block, New Delhi,
Dated September 23, 2013

ORDER


Subject: Constitution of a Committee to Review the FCCBs and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 1993.

--

The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 has undergone several amendments in piecemeal to meet the emerging needs of the economy. It has been decided to constitute a Committee to review the Scheme comprehensively keeping in view:

- i. the new company law and the recent legislations in the financial markets;
 - ii. the current state of the macro economy and the financial markets;
 - iii. the needs of the Indian companies and foreign investors; and
 - iv. the need for simplification and legal clarity of the Scheme.
2. The Committee shall have the following composition:
- | | |
|---|------------|
| i. Shri M. S. Sahoo, Secretary, ICSI | - Chairman |
| ii. Shri G. Padmanabhan, Executive Director, RBI | - Member |
| iii. Shri S. Ravindran, Executive Director, SEBI | - Member |
| iv. Prof. Ajay Shah, NIPFP | - Member |
| v. Shri P. R. Suresh, Consultant, PMEAC | - Member |
| vi. Shri Pratik Gupta, Managing Director, Deutsche Bank | - Member |
| vii. Shri Sanjeev Kaushik, Director (External Markets) | - Member |
- Convener
3. The Chairman may co-opt any such additional person (s) as invitees as necessary for any of the meeting (s) of the Committee.

3. The Chairman may co-opt any such additional person (s) as invitees as necessary for any of the meeting (s) of the Committee.
4. The Committee would meet as frequently as necessary for fulfillment of its objectives.
5. The NIPFP-DEA program team will be the secretariat for the Committee and all expenses related to the Committee's activities will be met from the budget of the NIPFP-DEA program supplemented as and when necessary.
6. The committee will finalise a draft scheme within 3 weeks from the date of its constitution and submit the same for further consideration.
7. This issues with the approval of competent authority.


23/09/2013

(Manu J. Vettickan)
Deputy Director (EM & ECB)
mj.vettickan@nic.in
Ph.23092682

Copy to:

1. All Members of the Committee.
2. Director (RE&C)
3. PPS to Secretary (EA)
4. PS to AS(DEA-K)

Annexure-A2

**F.No.9/1/ 2013-ECB
MINISTRY OF FINANCE
Department of Economic Affairs
(Capital Markets Division)**

North Block, New Delhi,
Dated January 1, 2014

ORDER

**Subject: Second Phase of the Committee to Review the FCCBs and Ordinary Shares
(Through Depository Receipt Mechanism) Scheme 1993.**

--

A committee has been constituted to review the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 vide office order of even number dated September 23, 2013. The committee submitted its recommendations related to depository receipts. It has been decided to extend the term of the committee to review the entire framework governing capital controls and foreign portfolio investment. This would include in particular review of framework relating to:

- (a). External Commercial Borrowings (ECBs) and FCCBs;
- (b). Direct listing of Indian companies abroad;
- (c). Dual listing of Indian companies;
- (d). Residence-based taxation vis-a-vis source based taxation; in respect of such instruments and
- (e). Relationship between authorities in India and in foreign jurisdictions.

2. The Committee shall have the following composition:

- | | |
|---|-------------------|
| i. Shri M. S. Sahoo, Secretary, ICSI | - Chairman |
| ii. Shri G. Padmanabhan, Executive Director, RBI | - Member |
| iii. Shri S. Ravindran, Executive Director, SEBI | - Member |
| iv. Prof. Ajay Shah, NIPFP | - Member |
| v. Shri P. R. Suresh, Consultant, PMEAC | - Member |
| vi. Shri Pratik Gupta, Managing Director, Deutsche Bank | - Member |
| vii. Shri. Somasekhar Sundaresan, Partner, JSA | - Member |
| viii. Shri. Bobby Parikh, Partner, BMR & Associates | - Member |
| ix. Shri Sanjeev Kaushik, Director (External Markets) | - Member Convener |

3. The Chairman may co-opt any such additional person (s) as invitees as necessary for any of the meeting (s) of the Committee.
4. The Committee would meet as frequently as necessary for fulfillment of its objectives.
5. The NIPFP-DEA program team will be the secretariat for the Committee and all expenses related to the Committee's activities will be met from the budget of the NIPFP-DEA program supplemented as and when necessary.
6. The committee will submit its report within three months from the date of its constitution.
7. This issues with the approval of competent authority.



(Manu J. Vettickan)
Deputy Director (EM & ECB)
mj.vettickan@nic.in
Ph.23092682

Copy to:

1. All Members of the Committee.
2. Director (RE&C)
3. PPS to Secretary (EA)
4. PS to AS(DEA-K)
5. PS to JS (FM)

Annexure-A3

**F.No.9/1/ 2013-ECB
MINISTRY OF FINANCE
Department of Economic Affairs
(Capital Markets Division)**

North Block, New Delhi,
Dated January 10, 2014

ORDER

Subject: Second Phase of the Committee to Review the FCCBs and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 1993.

--

A committee has been constituted to review the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 vide office order of even number dated September 23, 2013. The committee submitted its recommendations related to depository receipts. In partial supersession of this Departments' officer order of even number dated January 1, 2014 it has been decided to extend the term of the committee to review the framework relating to:

- (a). External Commercial Borrowings (ECBs) and FCCBs;
- (b). Indian Depository Receipts (IDRs)
- (c). Direct listing of Indian companies abroad;
- (d). Dual listing of Indian companies;
- (e). Residence-based taxation vis-a-vis source based taxation; in respect of such instruments and
- (f). Relationship between authorities in India and in foreign jurisdictions.

2. The Committee shall have the following composition:

- i. Shri M. S. Sahoo, Secretary, ICSI -
Chairman
- ii. Shri. Manoj Joshi, Joint Secretary (FM), DEA -
Member
- iii. Shri G. Padmanabhan, Executive Director, RBI -
Member

- | | | | |
|-------|---|---|--------|
| iv. | Shri S. Ravindran, Executive Director, SEBI | - | |
| | Member | | |
| v. | Prof. Ajay Shah, NIPFP | - | Member |
| vi. | Shri P. R. Suresh, Consultant, PMEAC | - | Member |
| vii. | Shri Pratik Gupta, Managing Director, Deutsche Bank | - | |
| | Member | | |
| viii. | Shri. Somasekhar Sundaresan, Partner, JSA | - | |
| | Member | | |
| ix. | Shri. Bobby Parikh, Partner, BMR & Associates | - | |
| | Member | | |
| x. | Shri Sanjeev Kaushik, Director (External Markets) | - | Member |
| | Convener | | |

3. The Chairman may co-opt any such additional person (s) as invitees as necessary for any of the meeting (s) of the Committee.
4. The Committee would meet as frequently as necessary for fulfillment of its objectives.
5. The NIPFP-DEA program team will be the secretariat for the Committee and all expenses related to the Committee's activities will be met from the budget of the NIPFP-DEA program supplemented as and when necessary.
6. The committee will submit its report within three months from the date of its constitution.
7. This issues with the approval of competent authority.

(Manu J.Vettickan)
 Deputy Director (EM & ECB)
mj.vettickan@nic.in
 Ph.23092682

Copy to:

1. All Members of the Committee.
2. Director (RE&C)
3. PPS to Secretary (EA)
4. PS to AS(DEA-K)
5. PS to JS (FM)

Annexure-A4

TELEGRAMS-
ECOFAIRS

. : 23092682
Fax : 23092271

File No. 9/1/2013-ECB
Government of India
Ministry of Finance
Department of Economic Affairs
(Capital Market Division)

New Delhi the February 5, 2014

ORDER

Subject: Second Phase of the Committee to Review the FCCBs and Ordinary Shares (Through Depository Mechanism) Scheme 1993.

In partial modification of this Department's order of even no. dated January 10, 2014 on the captioned subject (copy enclosed), **Shri Sunil Gupta, Joint Secretary (TPL II), Department of Revenue** is hereby nominated as a member of the Committee. The other provisions of the order dated January 10, 2014 remain the same.

2. This issues with the approval of Hon'ble Finance Minister.

(Sanjeev Kaushik)
Director (EM)
Tel. 23095046

To

Shri Sunil Gupta, Joint Secretary (TPL II)
Department of Revenue, MoF
North Block- New Delhi

Copy for information to:

1. All members of the Committee.
2. PSO/PPS to Secy. (EA)
3. PPS to Joint Secy. (FS)
4. PS to Director (EM)

Annexure-B

Stakeholders who engaged with the Committee

Sl No.	Name	Designation	Organisation
1.	Rabindra Kumar Das	Sr. VP, Treasury	Adani Group
2.	Juvenil Jani	CFO	Adani Mining Private Ltd.
3.	Sanjay Agarwal	MD, Global Corporate and Investment Banking Group	Bank of America
4.	Abhishek Garg	VP, Corporate Finance and Investment Banking	Bank of America Merrill Lynch
5.	Kaku Nakhate	Country Head (India)	Bank of America Merrill Lynch
6.	Nehal Vora	Chief Regulatory Officer	Bombay Stock Exchange
7.	Abhishek Agarwal	VP, Issuer Services - Sales Securities & Fund Services	Citibank
8.	Bhavna Thakur	Director, Head of Equity	Citigroup Global Markets India Private Ltd.
9.	Jeetendra Parmani	Capital Markets Organisation	Citigroup Global Markets India Private Ltd.
10.	Akalpit Gupte	Director Compliance	Deutsche Bank
11.	Jitendra Jain	CFO - Corporate Finance	GMR Group
12.	Kamalakara Rao Yechuri	Corporate CFO	GMR Group
13.	Maneesh Malhotra	MD, Head of Debt Finance, India	HSBC
14.	Manu J. Vettickan	Deputy Director	Ministry of Finance
15.	Hari K.	Vice President	National Stock Exchange
16.	R.N. Kar	CGM	RBI
17.	Anjan Patel	AGM	SEBI
18.	Pranav Variava	AM	SEBI
19.	V.S. Sundaresan	CGM	SEBI
20.	Kanchan Bhawe	Senior Manager - Corporate Secretariat	Standard Chartered
21.	LS Narayanswami	Director - Strategic Initiatives, India	Standard Chartered

Annexure-C

The Bharat Depository Receipts Guidelines, 2014

June 9, 2014

Contents

1	Preliminary	3
2	Definitions	3
3	Issue	5
4	Issue restrictions	6
5	Investment restrictions	6
6	Obligations	7
7	Taxation	7
8	Approval	8
9	Market Abuse	9
	Schedule 1: Permissible Jurisdictions	9

The Central Government hereby announces the following Guidelines for facilitating issue and trading of Bharat Depository Receipts in India, namely:-

1 Preliminary

1. These Guidelines may be called the Bharat Depository Receipts Guidelines, 2014.
2. These Guidelines reflect the policy intention of the Central Government to facilitate SEBI, RBI and Central Government to make appropriate provision in laws and regulations for issue and trading of bharat depository receipts in India.
3. These Guidelines shall be reviewed as and when the aggregate outstanding volume of bharat depository receipts, excluding Indian depository receipts, reaches a pre-specified percentage of the gross domestic product.

2 Definitions

1. In this Guidelines, unless the context otherwise requires:-
 - (a) ‘bharat depository receipt’ means a rupee denominated instrument issued by a domestic depository in India on the back of permissible securities issued or transferred to the domestic depository and deposited with a foreign custodian and includes ‘Indian depository receipt’ as defined in section 2(48) of the Companies Act, 2013;

Explanation I: Central Government shall declare ‘bharat depository receipts’ as ‘securities’ under section 2(h)(ia) of the Securities Contract (Regulation) Act, 1956.

Explanation II: There shall not be bharat depository receipts on a basket of different kinds of permissible securities.
 - (b) ‘domestic depository’ means a regulated person which:
 - i. is not prohibited from acquiring permissible securities; and

- ii. has legal capacity to issue bharat depository receipts in India;
- (c) ‘foreign custodian’ means a custodian of securities, a depository, or a bank in a permissible jurisdiction and having permission from its home regulator to provide services as custodian for the permissible securities;
- (d) ‘foreign depository’ means a depository which maintain ownership records of permissible securities in demat form in a permissible jurisdiction;
- (e) ‘foreign depository receipts’ means depository receipts issued and listed on an international exchange on the back of permissible securities;
- (f) ‘international exchange’ means a platform for trading of securities, which:
 - i. is in a permissible jurisdiction;
 - ii. is accessible to the public for trading; and
 - iii. provides pre-trade and post-trade transparency to the public;
- (g) ‘permissible jurisdiction’ means a foreign jurisdiction:
 - i. which is a member of the Financial Action Task Force on Money Laundering; and
 - ii. the regulator of the securities market in that jurisdiction is a member of the International Organisation of Securities Commissions;

Explanation: The list of permissible jurisdictions as on the date of notification is at Schedule 1 (Schedule 1 to be developed).
- (h) ‘permissible securities’ mean:
 - i. equities of foreign companies, or
 - ii. any other financial asset which may be acquired by a person resident in India under the Foreign Exchange (Management) Act, 1999,

which are listed on an international stock exchange and are held in demat form with a foreign depository.
- (i) ‘regulations’ means regulations made by SEBI under the SEBI Act, 1992;

- (j) 'SEBI' means the Securities and Exchange Board of India.
 - (k) 'unsponsored bharat depository receipts' mean bharat depository receipts issued without specific approval of the issuer of the permissible securities.
2. Words and expressions used and not defined in these Guidelines but defined in the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 or the Companies Act, 2013 or the Reserve Bank of India Act, 1934 or the Foreign Exchange Management Act, 1999 or the Prevention of Money Laundering Act, 2002 and the rules and regulations made thereunder shall have the meanings respectively assigned to them, as the case may be, in those Acts, rules or regulations.

3 Issue

1. An issuer of permissible securities or a person holding permissible securities, who has not been specifically prohibited from accessing the capital market or dealing in securities, as the case may be, may issue or transfer such securities to a foreign custodian for the purpose of issue of bharat depository receipts by a domestic depository.
2. An issuer may issue permissible securities to a domestic depository for the purpose of issuing bharat depository receipts by any permissible mode.
3. The holders of permissible securities may transfer such securities to a domestic depository for the purpose of issuing bharat depository receipts, with or without the approval of issuer of such permissible securities, through transactions on a recognised stock exchange, bilateral transactions or by tendering through a public platform.
4. A domestic depository may issue bharat depository receipts in India by way of a public offering, private placement or in any other manner in accordance with regulations.

4 Issue restrictions

1. The aggregate of permissible securities, which may be issued or transferred to domestic depositories for issue of bharat depository receipts, shall not exceed 25% of the size of the underlying permissible securities.
2. The bharat depository receipts may be converted at will to the underlying permissible securities and *vice versa*.
3. The proceeds of bharat depository receipts may be repatriated or invested in real economy in India.
4. The pricing of permissible securities and of the bharat depository receipts on such permissible securities shall not be regulated.
5. The bharat depository receipts shall be listed on a recognised stock exchange.

5 Investment restrictions

1. Indian as well as foreign investors - retail as well as institutional - are eligible to invest in bharat depository receipts.
2. There is no limit on investments by an investor in Indian depository receipts.
3. The investments in bharat depository receipts, other than in Indian depository receipts, is subject to the condition that the investments in permissible securities and in the bharat depository receipts on the back of such permissible securities taken together by an investor shall not exceed the limits permissible under the Foreign Exchange Management Act, 1999.
4. The investors in bharat depository receipts shall be allowed to participate in the currency futures market to hedge the currency risk associated with their investments in these receipts.
5. Unsponsored bharat depository receipts and foreign depository receipts shall not be accessible to retail and unsophisticated investors.

Explanation: SEBI may use appropriate measures of sophistication to identify unsophisticated investors.

6 Obligations

1. The domestic depository shall:
 - (a) ensure that the relevant provisions of these Guidelines related to the issue and cancellation of bharat depository receipts are complied with;
 - (b) maintain records in respect of, and report to, foreign depositories all transactions in the nature of issue and cancellation of bharat depository receipts for the purpose of monitoring limits under the Foreign Exchange Management Act, 1999;
 - (c) provide the information and data as may be called upon by SEBI, the Reserve Bank of India, Ministry of Finance, Ministry of Corporate Affairs and any other authority of law; and
 - (d) file with SEBI a copy of the document, by whatever name called, which sets the terms of issue of bharat depository receipts issued on the back of permissible securities.
2. The domestic depositories shall coordinate among themselves and disseminate:
 - (a) the outstanding permissible securities against which the bharat depository receipts are outstanding; and,
 - (b) the limit up to which permissible securities can be converted to depository receipts.
3. An issuer issuing or transferring permissible securities to a domestic depository for the purpose of issue of bharat depository receipts shall comply with relevant provisions of the Indian law, including the Regulations, related to the issue and cancellation of bharat depository receipts.

7 Taxation

1. The following shall not be considered as transfer under the Income Tax Act, 1961:
 - (a) issue or deposit of permissible securities to or with the domestic depository, as the case may be, for issuing of bharat depository

receipts;

- (b) issue of bharat depository receipts in India by the domestic depository on the back of permissible securities;
- (c) conversion of bharat depository receipts into permissible securities; and
- (d) conversion of permissible securities into bharat depository receipts.

Provided, however, that the conversion of bharat depository receipts into permissible securities by a non-resident Indian shall be considered transfer and be taxed accordingly.

2. The taxation regime applicable to transactions in domestic securities comparable to the underlying permissible securities shall apply to transactions in bharat depository receipts.

Explanation: If transactions in equities on stock exchanges are subject to STT, the transactions in bharat depository receipts with underlying equities shall be subject to STT.

3. The taxation regime applicable to returns on domestic securities comparable to underlying permissible securities shall apply to returns on bharat depository receipts.

8 Approval

1. Any approval necessary for issue or transfer of securities from a person resident outside India to a person resident in India or vice versa under the Foreign Exchange Management Act, 1999 shall apply to the issue or transfer of bharat depository receipts and permissible securities.
2. Subject to sub-paragraph 1, the issue of bharat depository receipts shall not require any approval from any government agency if the issuance is in accordance with the regulations.
3. SEBI shall be the exclusive regulator for issue and trading of bharat depository receipts and foreign depository receipts in India.
4. SEBI shall make regulations only from the perspective of investor protection.

5. SEBI shall specify the framework for issue and trading of bharat depository receipts and foreign depository receipts only through regulations.
6. Regulations may provide multiple level of bharat depository receipts with varying requirements to match the profile of different classes of investors.

9 Market Abuse

1. Any use, intended or otherwise, of permissible securities or market of permissible securities in a manner, which has potential to cause or has caused abuse of the market for bharat depository receipts in India, is market abuse and shall be dealt with accordingly.
2. For the purpose of this paragraph, market abuse means any activity prohibited under Chapter A of the Securities and Exchange Board of India Act, 1992.

Explanation: SEBI Act, 1992 may be amended to clarify extraterritorial jurisdiction of the SEBI Act, 1992 over market abuses abroad which may have negative implications for bharat depository receipts investors in India.

Schedule 1: Permissible Jurisdictions (to be developed)