

Explanatory Memorandum
Ministry of Company Affairs
REVIEW OF COMPANIES (ISSUE OF INDIAN DEPOSITORY
RECEIPTS) RULES, 2004

Background

1.1 The Central Government, in exercise of powers available with it under section 642 read with section 605A had prescribed the Companies (Issue of Indian Depository Receipts) Rules, 2004 (IDR Rules) vide notification number GSR 131(E) dated 23rd February, 2004.

1.2 The rules provide inter alia for (a) Eligibility for issue of IDRs (b) Procedure for making an issue of IDRs (c) Other conditions for the issue of IDRs (d) Registration of documents (e) Conditions for the issue of prospectus and application (f) Listing of Indian Depository Receipts (g) Procedure for transfer and redemption (h) Continuous Disclosure Requirements (i) Distribution of corporate benefits.

1.3 It has also been provided in such rules that an issuing company shall also fulfill the eligibility criteria laid down by SEBI from time to time in this behalf. (Rule 4(d)). The disclosure to be made in the prospectus to be filed with the SEBI and Registrar pursuant to rule 5(ii) has been prescribed in Schedule to the Rules and SEBI has been empowered under that Schedule to specify any other information not specifically mentioned in Schedule. SEBI, in view of authorization available to it under IDR Rules, have issued a circular dated 3/4/2006 in this regard. This circular is available on the website of SEBI.

Need and scope for modification of IDR Rules

2. Requests received from SEBI and other stakeholders for review of certain requirements provided in the IDR Rules have been examined in the Ministry of Company Affairs in consultation with D/o Economic Affairs and SEBI. The areas of IDR Rules which require certain modification have been indicated in the following paragraphs. A draft notification modifying relevant rules of IDR Rules is also attached to this Memorandum.

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3.1 Rule 4(a) of the IDR Rules provides that the pre-issue paid up capital and free reserves of the issuing company shall be at least US\$ 100 million, and the company would have an average turnover of US\$ 500 million during the last three financial years preceding the issue.

3.2 It has been informed that some countries require that a company issuing Depository Receipts should have at least 3 years operating record in the country where it is issuing Depository Receipts or elsewhere. It has been suggested and felt that similar requirement may be provided for in rule 4 of the IDR Rules. This may be helpful in establishing the track record of the issuing entity. Similarly, a minimum market capitalization requirement is followed internationally, both in US and UK in respect of companies which seek to raise funds through Depository Receipts. It has further been suggested that the turnover criteria is not found to be a satisfactory criterion for the purpose as it may not disclose the profitability or the market perception of the issuer. Hence a view has

been made that a minimum market capitalization requirement may be provided for. In view of this, it *has been felt to modify the requirement under existing rule 4(a) with the following:-*

(a) Its pre-issue paid-up capital and free reserves are at least US\$ 50 millions and it has a minimum average market capitalization (during the last 3 years) in domestic country of at least US\$ 100 millions;

(b) It has trading record/history in India or elsewhere for at least three years;

4. Rule 4(b) of the IDR Rules provides that the company proposing to issue IDRs should have been making profits for at least five years preceding the issue and has been declaring dividend of not less than 10% each year for the said period. *It has been brought to the notice that there are several companies in countries like USA which do not have the policy of declaring and paying dividends. These companies will be restricted from issuing IDRs due to such a provision. For domestic issues there is a requirement of profitability track record of 3 out of last 5 years. Suggestion has been made to omit the requirement of declaring dividend of not less than 10%. Further it has also been suggested that requirement of making profits for at least 5 years may be modified in line with domestic issues i.e. a profitability record for at least 3 out of last 5 years. Accordingly this rule is proposed to be modified as (new rule 4(c)) under:-*

(c) It has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least three out of immediately preceding five years

5. Rule 4(c) of IDR Rules states that the pre-issue debt equity ratio shall not be more than 2:1. It has been brought to the notice

that debt equity ratio of a company would depend on a range of factors including the industry it operates in and may not be indicative of the size or quality of a company. It has also been informed that there is no similar requirement for domestic issues. A suggestion has been made to omit or relax this requirement to a reasonable level. Since there is no such requirement for domestic issues, it is felt that this rule may be omitted.

6.1 Existing rule 5 (i)(a) of the rules provide that no issuing company shall raise funds in India by issuing IDRs unless it has obtained prior permission from the SEBI. For domestic issues, SEBI does not give any permission for issuers and only issues observations on offer documents filed with it as per Clause 2.1 of SEBI (DIP) Guidelines 2000. It has been suggested that suitable modification in this clause may be made to indicate in a clear manner the role of SEBI in clearing Offer documents relating to IDRs.

6.2 It is proposed that the following principle may be incorporated that no issuing company shall raise fund in India by issuing IDRs unless its prospectus has been submitted to SEBI in the form prescribed and any comments/observations/requirements pointed out by SEBI have been complied with to the satisfaction of SEBI. Necessary changes have accordingly been made in Rule 5 which can be seen in the draft notification attached to this Memorandum.

7. Rule 6(iii) of the IDR Rules states that IDRs issued by any issuing company in any financial year shall not exceed 15 % of its paid up capital and free reserves. *It has been informed that this criterion will limit the issue size to a proportion of the value of paid up capital and free reserve. This stipulation may also limit the free*

float and subsequent liquidity of IDRs. It has been suggested that this rule may be modified as under:-

“(iii) The number of underlying equity shares offered in a financial year through IDR offerings shall not exceed 25 per cent of the post issue number of equity shares of the company”

8. Rule 11(ii) of IDR Rules stipulates that the quarterly audited financial results should be prepared and published in newspapers in the manner specified by the listing conditions. *Attention has been drawn to clause 41 of the Listing Agreement which provides for publishing unaudited quarterly results with a limited review report by the auditor of the company. In many other countries, it has been informed, companies are generally not required to provide audited quarterly results. Since IDRs are to be listed and traded in India, the rules applicable for domestic issuers should be made applicable. It has accordingly been suggested that publishing of unaudited quarterly results subject to a limited review by auditors may be allowed. This clause is accordingly proposed to be modified as under:-*

“(ii) The quarterly audited results or unaudited results subjected to limited review by the auditors of the company and duly approved by the Board of Directors of the issuing company, as the case may be, shall be prepared and published in the manner specified in the listing conditions”

9. Paragraph 5 (ii) of Schedule to IDR Rules states that description of “Promoters and their background” should be disclosed in the Prospectus. *It has been informed that many listed*

foreign companies having large public shareholding are managed by the Board of Directors and do not have identified promoters. It has been suggested that this provision may be modified as under:-

“(ii) promoters and their background.

Provided that in case there are no identifiable promoters, the names, addresses and other particulars as may be specified by SEBI of all the persons who hold 5% or more equity share capital of the company shall be disclosed”.

10. Paragraph 6 of Schedule to IDR Rules states that the Prospectus should contain a report certified by an Accountant who is member of Institute of Chartered Accountants of India holding certificate of practice upon profits or losses of the issuing company for each of the five financial years immediately preceding the issue of prospectus and upon the assets and liabilities of the issuing company at the last date to which the accounts of the company were made in the specified form; provided that the gap between date of issue and date of report shall not be more than 120 days. *It has been brought to the notice that for domestic issues audited results should be given for a period of 5 years and should not be older than 6 months (180 days) from the date of opening of issue. It has been suggested that the gap indicated in the paragraph to 120 days may be modified to 180 days. Necessary change, accordingly, has been proposed in the draft notification attached.*

11. *The rules have also been proposed to be amended to specifically indicate at rule 5(i)(g) and rule 7(ii) that for the purpose of*

these rules, the concerned Registrar would be the Registrar of Companies, New Delhi.

Draft Notification

12. Based on above proposals, a draft notification proposing modifications in the Companies (Issue of IDRs) Rules, 2004 has been prepared and is **annexed** to this Memorandum. Suggestions/Comments on the draft notification alongwith justification in brief may be addressed/sent latest by 28th March, 2007 to Shri Diwan Chand, Director, Inspection and Investigation or Shri N.K. Dua, Assistant Director, M/o Company Affairs, 5th Floor, A Wing, Shastri Bhavan, New Delhi. The suggestions/comments may also be sent through email at diwan.chand@mca.gov.in or narendra.dua@mca.gov.in. It will be appreciated if the name and address of the sender is also indicated clearly at the time of sending suggestions/comments.

“ [idr draft notification feb 2007](#) ”
