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Mobilization of Resources International Capital Market in Special Reference with Depository Receipts

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Abstract

This research article focuses on the whole concept of Globalization of capital markets with special reference with Depository Receipts as one of its resource and also increasing trends of globalization of capital markets and its essential ingredients, like emergence of innovative financial instruments and trade tricks and techniques on global level of market, the friendly connection between money and capital market across the world, liberal trade regulations in the field of various sectors of economies in most of the developing and developed countries, tremendous development of digitization and electronic techniques of funds transfer, especially digital economy are few essential ingredients behind the growth of Globalization of capital markets. The Global Depository Receipts and American Depository Receipts, its legal framework and its various aspects. The article also attempts to analyze the need of the hour for formulation of strong steps and policies to curb the fiascos in coming future of International Capital Market and expand its scope of success parameters.

Keywords: *International Capital Market, American Depository Receipts (ADR), Global Depository Receipts (GDR), Depository Receipts (DR), Globalization, Mobilization of Resources*

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INTRODUCTION

It could be undoubtedly stated that the trends towards Globalization of capital markets has increased over the last decades or so rapidly with tremendous developments amendments in laws, rules and regulations to ease the flow of Globalization of capital markets.

With the whirlwind quantum development in the field of capitalism, communication, technology has turned the globe into a huge stock exchange. Now few questions need to be answered in order to understand the whole concept of Globalization of capital markets and mobilization of resource in capital market. The very first question is what is the concept of global market?

In words of Richard A. Acks, President of Morgan Stanley, a developing global market is, which has no national boundaries, to which participants-be they investors, issuers, borrowers, or savers—from all over the world has access, in which price is established by supply and demand from around the world, not from a domestic market, and in which transaction can be affected, on a twenty four hour basis or close to it [1].

Now the second question arises what is leading to torrent growth and expansion of Globalization of capital markets. Below are few reasons given:

1. Emergence of innovative financial instruments and trade tricks and techniques on global level of market.
2. The friendly connection between money and capital market across the world.
3. Liberal trade regulations in the field of various sectors of economies in most of the developing and developed countries.
4. Tremendous development of digitization and electronic techniques of funds transfer, especially digital economy is also an essential ingredient behind the growth of Globalization of capital markets.

5. The search for better market environment and better capital return and friendly facilitation of mobilization of resources in capital market also lead to increase in scope of Globalization of capital markets.
6. The allocation of best possible capital at very competitive merit has contributed in the area prominently.
7. Opening of road to techniques for boosting funds in larger market in most rock bottom way is another reason for rapid growth of Globalization of capital markets.
8. Profit sharing of intermediaries in international capital market promotes the increase in Globalization of capital markets opportunities.

Trends Indicating Increasing Globalization

Globalization of capital markets existed even in those eras when Silk Road started in China constructed silk roads to reach the frontier of the Persian Empire and enlarged it towards the Roman Empire during the Roman, Persian and Chinese Empire. It even existed when Portuguese reached India during 16th and 17th centuries for global integration of trade and capital through the augmentation of European trade. These are the few evidences of the abundance of such incidences, indicating the existence of mobilization of resources in foreign/global markets and Globalization of capital markets.

With the passage of time and centuries the trend got moving towards its expansion until the eighties and nineties. The era of eighties and nineties witnessed the abrasive barriers for allocation of free marketplace.

It was in the year 1992, that Richard C. Breeden of the U.S. Securities Exchange Commission (SEC) pointed towards the below evident facts for globalization of capital market:

(a) Out of every seven equity orders, at least one order worldwide involves a foreign party.
(b) There has been significant increase of average 4 billion US dollars every day in the sale and purchase of foreign securities issues in 1992, showing one third of growth since 1990.
(c) Combined assets of approximately 66 billion US dollars were invested in foreign securities only.
(d) Approximately 10% of all trading in US' equities took place outside the USA.
(e) After the year 1992, British funds have increased their portfolio of international investments to 1.8% of their total portfolio from 7% [2].

This trend was continued since then. However, recently OECD (Organization for Economic Co-operation and Development) came up with a new data which revealed that Foreign Direct Investment (FDI) dropped by 27% to USD 1 097 billion in 2018. This represents 1.3% of global GDP, the lowest level since 1999. The fall was largely due to the 2017 US tax reform which prompted US parent companies to repatriate large amounts of earnings held with foreign affiliates [3]. But then also other countries in Asia, Europe and Australia are clearly indicating the significant growth in globalization of capital market.

Legal and Substantive Problems in Globalization

Clearance and Settlement Process

Every country/exchange has formulated its own set of customs and practices in this regard, but one should frame the laws keeping in mind the need to formulate most secured, convenient and swift besides being uniform in nature. Some of the common problems arising under this head are discussed below:

Conflict of Laws—In absence of uniform law, different of laws are governing both the parties (Seller and buyer) which makes both the parties in conflict regarding the issue of valid cross-border transfer.

Credit Risk—U.S.A. smart policies in this regard acts as an umbrella for its investors by safeguarding its investors from bankruptcy. Other than U.S.A most of the countries have not heeded on these issues.

Currency Risk—Currency rate fluctuation between the period of starting from the agreement to deal till the actual settlement of deal, may discourage and play negative role in locking of smooth trade by upsetting the whole deal cost and calculations.

Different Customs and Practice and Regulatory Differences—Though most of the developing countries have adopted the concept of digital economy but this problem arises where the physical delivery is required-coupled with other problems like different settlement cycles converting the process into a complicated one.

Taxes—Like as stated above report by OECD, it has become crystal clear that taxation system plays a very crucial role in globalization of capital market. For example, the recent tax reforms in U.S.A. are discouraging the capital market on global label to great extent.

Disclosure Requirements and Accountancy Standards
Even steps towards accepting on a reciprocal basis the form of a prospectus among countries like, U.K., U.S.A., Canada does not offer a realistic solution as the legality is still governed by the foreign law. Markets on individual level require to set a very high and efficient set of standards channelize the accountancy.

Different Marketing Procedures
A multinational offering would require following different marketing procedure for different countries, for e.g., U.S. allows only road shows and prospectus whereas U.K. promotes large scale advertising media.

Regulatory Discrepancies
Firstly, there is strong need for international co-operation in regulation among various regulators to co-operate in investigating wrongdoing and catch the wrong doers. Secondly, the regulatory author requires developing a strong nexus of information in this regard. It would be very difficult as most of the operations are conducted outside the home jurisdiction. Thirdly, there is a unsolved question of who should regulate this global market and what formulation of regulation is required. Though it is not possible to adopt uniform trading structures and standards due to cultural and historical variations, there is great necessity to decide upon the essential ingredients for a fair and efficient market.

MEANING AND EXPRESSION OF MOBILIZATION OF RESOURCE IN INTERNATIONAL CAPITAL MARKET

Mobilization of resource means procedure assembling resources or stocks or supply for achieving collective goal. The purpose of this process is better utilization of available resources. New trends have defined the activity of mobilization of resources in new form or in other words it means and is used these days to refer 'new business development/opportunities.

Mobilizing resources in international capital market means assembling of resources from different countries of the world for best available utilization technique with the common goal for achieving maximum profit out of the said deal.

Introduction and Meaning of Euro Issue
The term 'Euro-Issue' denotes the issue of both bond as well as bond. A Euro bond is an international bond which is issued on behalf of a multinational corporation, international agency or sovereign State to investors from across the globe.

In India**,** the Foreign Currency Convertible Bond (FCCB) which is an equity related debt forms the basis of the Indian Euro bond issues. FCCEs are freely tradable and carry the option of converting either into depository receipts or equities. Global Depository Receipt (GDR) is the mechanism to issue the FCCB.

Euro Issue are governed by the following regulations in India:

1. The Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme,1993.
2. Foreign Currency Exchangeable Bonds Scheme, 2008
3. Depository Receipts Scheme, 2014
4. Notifications/Circulars issued by Ministry of Finance (MoF), GOI.
5. Consolidated FDI Policy. RBI Regulations/Circulars.
6. Companies Act and Rules there under.
7. Listing Regulations.

Meaning and Historical Background of GDR

A GDR has been defined as "any instrument in the form of a depository receipt or certificate created by the Overseas Bank outside India and issued to non-resident investors against the issue of ordinary shares or FCCBs of the issuing company." The GDR is thus a method of foreign direct investment in India.

In western capital markets the concept of GDRs has been used since early nineteenth century. They were designed as an instrument to enable U.S., investors to trade in securities that were not listed in U.S. exchanges, in the form of American Depository Receipts (ADRs). Under this, a U.S. based depository bank would buy some shares in the foreign company through a broker in the country where the company's shares are listed. The depository bank would then issue receipts against these shares which would be freely traded on an American exchange. However, in 1983, the Securities Exchange Commission (SEC) of U.S.A. made it mandatory for companies to make registration.

Similarly, International Depository Receipts (IDRs) were in vogue in U.K. and Europe to enable investors to trade in securities not listed in those exchange.

Till 1990, companies had to issue separate depository receipts in U.K. and U.S.A, and consequently no cross border trading of these receipts was possible as ADRs had to be traded, settled and cleared through the T.S, system of Generally Accepted Accounting Principles (GAAP), while IDRs could only be traded and settled in U.K. and Europe.

In 1990, S.E.C. of U.S.A. made changes in Rule 144A and Regulation 5 of the S.E.C, which allowed companies to raise capital without having to register the securities within the S.E.C. or changing financial statements to reflect the U.S. G.A.A.P. The system of GDRs evolved out of these changes.

The basic difference between ADRs and GDRs is that ADR are US $ denominated and traded in US and GDRs are traded in various places such as New York Stock Exchange, London Stock Exchange, etc.

Dr. Manmohan Singh, the then finance minister in 1992 took credit to introduce the concept of raising capital through issue of shares' in foreign capital market in India. He announced the Government's plan to permit same, in his budget speech. Reliance Industries Limited for the very first time in Indian history, entered the global market with and Euro-Issue of $ 150 million in the year May, 1992 [4].

Various modes of GDRs have been described below through Figure 1 [5]:

DEPOSITORY RECEIPTS

Depository Receipt (DR) is a negotiable instrument evidencing a fixed number of equity shares of the issuing company being an Indian company, denominated in foreign currency and is being traded in foreign exchanges [6].

Purpose for Issuing DRs by a Company

a. To raise Capital, Diversify Shareholder base into extended geographies
b. Facilitate Merger & Acquisition activity by creating a desirable acquisition currency.
c. Set Up Employee Stock Option Plans
d. Increase visibility & recognition in international market Global Image

Purpose of Investors to Invest in Depository Receipts

- Diversify Portfolio Convenience of holding foreign securities in their markets
- No restrictions on dealing: DRs are recognized as domestic securities
- Avoid Currency risk.
- Simplification of trading and settlements (DRs trade and settle just like US or EURO securities)

Classification of Depository Receipts

Sponsored DRs—There exist a formal agreement between Indian issuer and foreign depository for creation or issue of DRs under this class. It can be further classified into two:

Capital Raising—Under this, the issuer deposits newly issued securities with the DCB and the ODB creates/issues DRs abroad to international investors for sale.

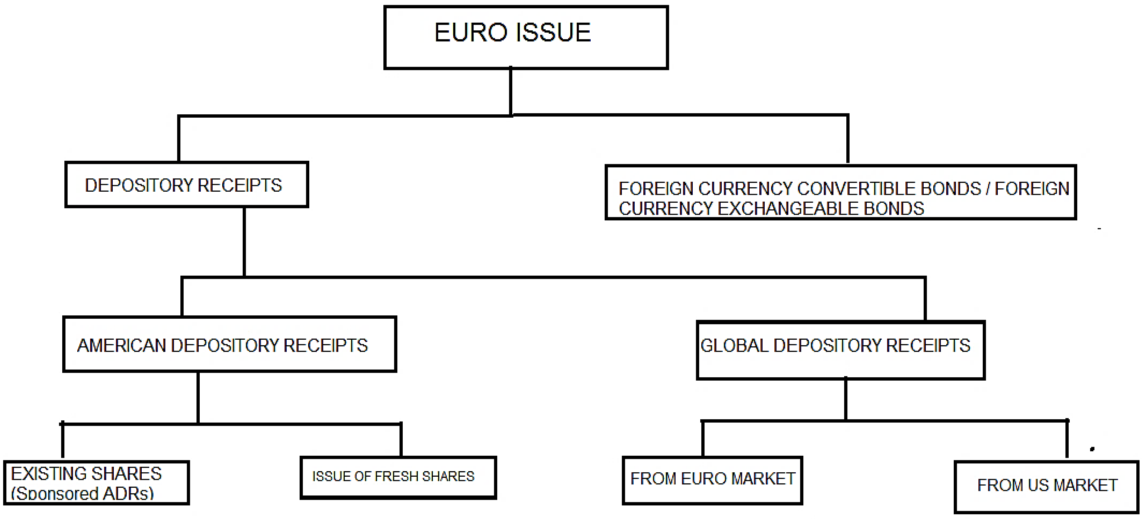

Fig. 1: *Various modes of GDR's.*
(Source: https://www.taxdose.com/wp-content/uploads/2016/08/new.png.)

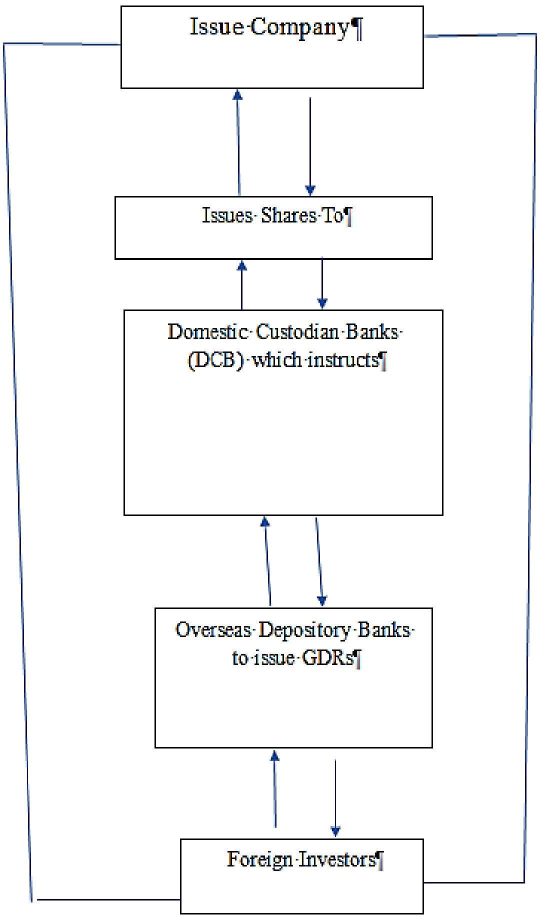

Fig. 2: *Operating Mechanism of DRs.*

Non-Capital Raising—Under this, in place of a newly bought securities, the issuer gets hold of its old existing one to deposit with DCB and the ODB creates/issues DRs abroad to international investors for sale

Unsponsored DRs—There exists no formal agreement between the foreign depository and the Indian issuer under this. It can be further classified into two:

- **Listed**—Listed DRs are traded on Stock Exchanges.
- **Unlisted**—Unlisted DRs are inter-traded between parties and not listed on any stock exchanges.

In Indian context, Depository Receipts are otherwise known as Foreign Direct Investment (FDI) and the key players in the DRs Process are discussed below and also illustrated through Figure 2:

1. The Issuer Company—The Issuer Company is an Indian Company eligible to issue DRs/FCCBs through the DR mechanism which involves entering into an agreement with the Overseas Depository Bank (ODB) in order to create and issue depository receipts or certificates. DRs/FCCBs are issued in accordance with the guidelines issued by the Government of India under Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and DR Scheme 2014 respectively but it may be amended from time to time as per requirements.
2. The ODB—The Overseas Depository Banks the investment banks which creates and issues DRs or Certificate to the

investors across the globe. DRs are freely traded foreign currency dominated instruments issued in a permissible jurisdiction against a pool of permissible securities transferred to the ODB and deposited with DCB (Domestic Custodian Bank).

3. DCB—The Domestic Custodian Banks is located in India and it keeps the shares on behalf of the ODB and ensures that those shares don't leave the country.
4. The International Investor—It is the actual buyer of the DRs/Certificates, representing the shares and could be either investor, institution or individual.

Apart from the aforesaid players there are common market players like manager, banker to the issue, brokers etc., and are present on both sides, domestic and foreign.

Operating Mechanism

'Depository Receipt' (DR) means a negotiable security issued outside India by a Depository bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian bank in India. DRs are traded on Stock Exchanges in the US, Singapore, Luxembourg, etc. DRs listed and traded in the US markets are known as American Depository Receipts (ADRs) and those listed and traded anywhere/elsewhere are known as Global Depository Receipts (GDRs). DRs are governed by Notification No. FEMA 330/ 2014-RB, issued by Reserve Bank of India [7].

Conditions

a. FCCBs/DRs may be issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and DR Scheme 2014 respectively, as per the guidelines issued by the Government of India there under from time to time.
b. DRs are foreign currency denominated instruments issued by a foreign Depository in a permissible jurisdiction against a pool of permissible securities issued or transferred to that foreign depository and deposited with a domestic custodian.
c. In terms of Notification No. FEMA.20/2000-RB dated May 3, 2000 as amended from time to time, a person will be eligible to issue or transfer eligible securities to a foreign depository, for the purpose of converting the securities so purchased into depository receipts in terms of Depository Receipts Scheme, 2014 and guidelines issued by the Government of India there under from time to time.
d. A person can issue DRs, if it is eligible to issue eligible instruments to person resident outside India under Schedules 1, 2, 2A, 3, 5 and 8 of Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time.
e. The aggregate of eligible securities which may be issued or transferred to foreign depositories, along with eligible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such eligible securities under the relevant regulations framed under FEMA, 1999.
f. The pricing of eligible securities to be issued or transferred to a foreign depository for the purpose of issuing depository receipts should not be at a price less than the price applicable to a corresponding mode of issue or transfer of such securities to domestic investors under the relevant regulations framed under FEMA, 1999.
g. The issue of depository receipts as per DR Scheme 2014 shall be reported to the Reserve Bank by the domestic custodian as per the reporting guidelines for DR Scheme 2014 [8].

Regulatory Framework in Operating Mechanism of DRs

*Permissible Jurisdiction— "*Permissible Jurisdiction" is a member of the Financial Action Task Force on money laundering and the regulator of the securities market in that jurisdiction is a member of the International Organization of Securities Commission.

Depository Receipts Scheme, 2014

'Depository Receipts Scheme, 2014' (DR Scheme, 2014) for investments under ADR/GDR have been notified by the Central Government effective from December 15, 2014 which provides for repeal of extant guidelines for Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 except to the extent relating to foreign currency convertible bonds.

The salient features of the scheme are:

- The securities in which a person resident outside India is allowed to invest under Schedule 1, 2, 2A, 3, 5 and 8 of Notification No. FEMA. 20/2000-RB dated 3rd May 2000 shall be eligible securities for issue of Depository Receipts in terms of DR Scheme 2014;
- A person will be eligible to issue or transfer eligible securities to a foreign depository for the purpose of issuance of depository receipts as provided in DR Scheme 2014.
- The aggregate of eligible securities which may be issued or transferred to foreign depositories, along with eligible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such eligible securities under the extant FEMA regulations, as amended from time to time.
- The eligible securities shall not be issued to a foreign depository for the purpose of issuing depository receipts at a price less than the price applicable to a corresponding mode of issue of such securities to domestic investors under FEMA, 1999.
- It is to be noted that if the issuance of the depository receipts adds to the capital of a company, the issue of shares and utilisation of the proceeds shall have to comply with the relevant conditions laid down in the Regulations framed and Directions issued under FEMA, 1999.
- The domestic custodian shall report the issue/transfer of sponsored/unsponsored depository receipts as per DR Scheme 2014 in 'Form DRR' as given in Annex within 30 days of close of the issue/ program [9].

FOREIGN EXCHANGE MANAGEMENT ACT, 1999 (FEMA)

FEMA makes provisions for dealings in foreign exchange. Broadly, all Current Account Transactions are free. However Central Government can impose reasonable restrictions by issuing rules (Section 3 FEMA). Capital Account Transactions are permitted to the extent specified by RBI by issuing Regulations (Section 6 of FEMA).

FDI Policy announced by Department of Industrial Policy & Promotion, Ministry of Industries and Commerce directly relevant to understanding the provisions of FEMA.

Instructions/Guidelines etc. of Ministry of Finance and Securities and Exchange Board of India (SEBI) become relevant when (ECB) /ADR/GDR and capital market is involved [10].

Under the provisions as provided through Notification No. FEMA.20/2000-RB dated May 3, 2000 as amended from time to time, a person will be eligible to issue or transfer eligible securities to a foreign depository, for the purpose of converting the securities so purchased into depository receipts in terms of Depository Receipts Scheme, 2014 and guidelines issued by the Government of India there under from time to time.

The aggregate of eligible securities issued or transferred to overseas depositories, or securities held by a foreign person, must be within the limit on foreign holding of such eligible securities under the relevant regulations framed under FEMA, 1999.

A person can issue DRs, if it is eligible to issue eligible instruments to person resident outside India under Schedules 1, 2, 2A, 3, 5 and 8 of Notification No. FEMA 20/2000-RB dated May 3, 2000, as amended from time to time.

The pricing of eligible securities to be issued or transferred to a foreign depository for the purpose of issuing depository receipts should be strictly as per prescribed price structure applicable to a corresponding mode of issue or transfer of such securities to domestic investors under the relevant regulations framed under FEMA, 1999.

Companies (Issue of Global Depository Receipts) Rules, 2014 Notification No. GSR 252(E) [F.No.1/21/13-Cl-V], Dated 31-3-2014

These rules are formulated by the Central Government in exercise of the powers conferred by section 41 read with 469 of the Companies Act, 2013.

Few important provisions of the same are given below:

Eligibility to issue depository receipts

A company may issue depository receipts provided it is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations.

Conditions for issue of depository receipts

(1) The Board of Directors of the company intending to issue depository receipts shall pass a resolution authorizing the company to do so.

(2) The company shall take prior approval of its shareholders by a special resolution to be passed at a general meeting:

Provided that a special resolution passed under section 62 for issue of shares underlying the depository receipts, shall be deemed to be a special resolution for the purpose of section 41 as well.

(3) The depository receipts shall be issued by an overseas depository bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank.

(4) The company shall ensure that all the applicable provisions of the Scheme and the rules or regulations or guidelines issued by the Reserve Bank of India are complied with before and after the issue of depository receipts.

(5) The company shall appoint a merchant banker or a practicing chartered accountant or a practicing cost accountant or a practicing company secretary to oversee all the compliances relating to issue of depository receipts and the compliance report taken from such merchant banker or practicing chartered accountant or practicing cost accountant or practicing company secretary, as the case may be, shall be placed at the meeting of the Board of Directors of the company or of the committee of the Board of directors authorized by the Board in this regard to be held immediately after closure of all formalities of the issue of depository receipts:

Provided that the committee of the Board of directors referred to above shall have at least one independent director in case the company is required to have independent directors.

Manner and form of depository receipts

(1) The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

(2) The depository receipts may be issued against issue of new shares or may be sponsored against shares held by shareholders of the company in accordance with such conditions as the Central Government or Reserve Bank of India may prescribe or specify from time to time.

(3) The underlying shares shall be allotted in the name of the overseas depository bank and against such shares, the depository receipts shall be issued by the overseas depository bank abroad.

Voting rights

(1) A holder of depository receipts may become a member of the company and shall be entitled to vote as such only on conversion of the depository receipts into underlying shares after following the procedure provided in the Scheme and the provisions of this Act.

(2) Until the conversion of depository receipts, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.

Proceeds of issue

The proceeds of issues of depository receipts shall either be remitted to a bank account in India or deposited in an Indian bank operating abroad or any foreign bank (which is a Scheduled Bank under the Reserve Bank of India Act, 1934) having operations in India with an agreement that the foreign bank having operations in India shall take responsibility for furnishing all the information which may be required and in the event of a sponsored issue of Depository Receipts, the proceeds of the sale shall be credited to the respective bank account of the shareholders.

Depository receipts prior to commencement

(1) A company which has issued depository receipts prior to commencement of these rules shall comply with the requirements under these rules within six months of such commencement.

(2) Any issue of depository receipts after six months of commencement of these rules shall be in accordance with the requirements of these rules.

Non applicability of certain provisions of the Act

(1) The provisions of the Act and any rules issued thereunder insofar as they relate to public issue of shares or debentures shall not apply to issue of depository receipts abroad.

(2) The offer document, by whatever name called and if prepared for the issue of depository receipts, shall not be treated as a prospectus or an offer document within the meaning of this Act and all the provisions as applicable to a prospectus or an offer document shall not apply to a depository receipts offer document.

(3) Notwithstanding anything contained under section 88 of the Act, until the redemption of depository receipts, the name of the overseas depository bank shall be entered in the Register of Members of the company [11].

Two-Way Fungibility Scheme

Under the above said scheme, the investors have the option to freely convert the depository receipts into underlying domestic shares and vice versa.

Operative guidelines for the limited two-way Fungibility under the "issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993" [12] (As issued by the Government of India)

a. Re-issuance of ADR/GDR would be permitted to the extent of ADRs/GDRs which have been redeemed into underlying shares and sold in the domestic market. The arrangement is demand driven with the process of reconversion emanating with the request for acquisition of domestic shares by non-resident investor for issue of ADRs/GDRs.
b. Investments under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme,1993 is treated as direct foreign investment. Accordingly, the transaction under the reconversion arrangement will be distinct and separate from FII portfolio investments.
c. The transaction will be affected through Securities and Exchange Board of India (SEBI) registered stockbrokers as intermediaries between foreign investors and domestic shareholders. A general permission has been conveyed by Reserve Bank of India (RBI) through a Notification No. FEMA.41/2001-RB dated 2nd March 2001 authorising such stockbrokers to acquire domestic shares on behalf of the overseas investors for being placed with the domestic custodian.
d. For this purpose, all SEBI registered brokers will be able to act as intermediary in the two-way fungibility of ADRs/GDRs. RBI has conveyed general permission through a Notification No. FEMA.41/2001-RB dated 2nd March 2001 for these brokers to buy shares on behalf of the overseas investor.
e. As a secondary market transaction, the acquisition of such shares through the intermediary on behalf of the overseas investors would fall within the regulatory purview of SEBI. The Custodian would monitor the re-issuance and furnish a certificate to both RBI & SEBI to ensure

that the sectoral caps are not breached. RBI would monitor the receipt of certificates from the Custodian to this effect.

f. The domestic custodian who is the intermediary between overseas depository on the one hand and Indian company on the other will have the record of the ADRs/GDRs issued and redeemed and sold in the domestic market.
g. The domestic custodian will also be required to ascertain the extent of registration in favour of ADR/GDR holders/non-resident investor based on the advice of Overseas Depository to the Domestic custodian for the underlying shares being transferred in the books of account of the issuing company in the name of the non-resident on redemption of the ADRs/GDRs.
h. the custodian is also required to verify with the Company Secretary/NSDL/CDSL if the total cap is being breached if there is a percentage cap on foreign direct investment.
i. On request by the overseas investor for acquisition of shares for re-issuance of ADRs /GDRs, the SEBI registered Broker will purchase a given number of shares after verifying with the custodian whether there is any Head Room available:
j. Head Room= Number of ADRs/GDRs originally issued minus number of GDRs outstanding further adjusted for ADRs/GDRs redeemed into underlying shares and registered in the name of the non-resident investor(s). The domestic custodian would notify the extent up to which re-issuance would be permissible—the redemption effected minus the underlying shares registered in the name of the non-resident investor with reference to original GDR issue and adjustment on account of sectoral caps/approval limits.
k. The Indian Broker would receive funds through normal banking channels for purchase of shares from the market. The shares would be purchased in the name of the Overseas Depository and the shares would need to be purchased on a recognized stock exchange.
l. Upon acquisition the Indian Broker would place the domestic share with the custodian; the arrangement would require a revised custodial agreement under which the custodian would be authorized by the company to accept shares from entities other than the company
m. Custodian would advise overseas depository on the custody of domestic share and that corresponding ADRs/GDRs may be issued to the non-resident investor.
n. Overseas depository would issue corresponding ADRs/GDRs to the investor.
o. The domestic custodian in addition would have to ensure that the advices to the overseas depository is issued on the first come first serve basis i.e. the first deposit of domestic /underlying shares with a custodian shall be eligible for the first re-issuance of ADRs/GDRs to the overseas investors.
p. The custodian would also have to ensure that ordinary shares only to the extent of the depletion in ADR/GDRs stock are deposited with it. This can be readily ensured by adopting a system similar to the trigger mechanism adopted for FIIs. Once the trigger mechanism is reached, say at 90% of the depletion in the ADR/GDR stock, each buying transaction of domestic shares would be complete only after the custodian has approved it.
q. A monthly report about the ADR/GDR transaction under the two-way fungibility arrangement is to be made by the Indian Custodian in the prescribed format to RBI and SEBI.
r. The Broker has to ensure that each purchase transaction is only against delivery and payment thereof is received in foreign exchange.
s. The Broker will submit the contract note to the Indian custodian of the underlying shares on the day next to the day of the purchase so that the Custodian can reduce the Head Room accordingly. Copy of the Contract Note would also need to be provided by the custodians to RBI and SEBI. The Broker will also ensure that a separate rupee account will be maintained for the purpose of buying shares for the purpose of effecting two-way fungibility. No forward cover will be available for the amounts lying in the said rupee account.

The ADs will be permitted to transfer the monies lying in the above account on the request of the Broker.

t. The custodian of the underlying shares and the Depositories would coordinate on a daily basis in computing the Head Room. Further, the company secretary of each individual company would provide details of non-resident investment at weekly intervals to the custodian and the depository. The custodian would monitor the re-issuance and furnish a certificate to both RBI & SEBI, to ensure that the sectoral caps are not breached. RBI would monitor the receipt of certificates from the custodian to this effect.

u. The re-issuance would be within the already approved/issued limits and would only effectively mean transfer of ADRs/GDRs from one non-resident to another and accordingly no further approval mechanism be insisted upon.

v. In the limited two-way fungibility arrangement, the company is not involved in the process and is demand driven i.e. request for ADRs/GDRs emanates from overseas investors. Consequently, the expenses involved in the transaction would be borne by the investors, which would include the payments due to overseas intermediary/broker, domestic custodians, charges of the overseas and domestic brokers.

w. The tax provision under Section 115 AC of the Income Tax Act 1961, which is applicable to non-resident investors investing in ADRs/GDRs offered against issue of fresh underlying shares would extend to non-resident investors investing in foreign exchange in ADRs/GDRs issued against existing shares under these guidelines, in terms of the relevant provisions of the Income Tax Act 1961.

Sponsored ADR/GDR Issue—Ministry of Finance has issued guidelines to regulate ADR/GDR Issue. In terms of Regulation 4B of the said Notification, an Indian company may sponsor an issue of ADRs/GDRs with an overseas depository against shares held by its shareholders at a price to be determined by the Lead Manager, subject to compliance with provisions of the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and guidelines issued by the Central Government from time to time.

GUIDELINES FOR ADR/GDR ISSUES BY THE INDIAN COMPANIES: Disinvestment of Shares by the Indian Companies in the Overseas Market through Issue of ADRs/GDRs [13]

i. Divestment by shareholders of their holdings of Indian companies, in the overseas markets would be allowed through the mechanism of Sponsored ADR/GDR issue in respect of:

a. Divestment by shareholders of their holdings of Indian companies listed in India;

b. Divestment by shareholders of their holdings of Indian companies not listed in India but which are listed overseas.

ii. The process of divestment would be initiated by such Indian companies whose shares are being offered for divestment in the overseas market by sponsoring ADR/GDR issues against the block of existing shares offered by the shareholders under the provisions of these guidelines.

iii. Such a facility would be available pari-passu to all categories of shareholders, of the company whose shares are being sold in the ADR/GDR markets overseas. This would ensure that no class of shareholders gets a special dispensation.

iv. The sponsoring company, whose shareholders propose to divest existing shares in the overseas market through issue of ADRs/GDRs will give an option to all its shareholders indicating the number of shares to be divested and the mechanism how the price will be determined under the ADR/GDR norms. If the shares offered for divestment are more than the pre-specified number to be divested, shares would be accepted for divestment in proportion to existing holdings.

v. The proposal for divestment of the existing shares in the ADR/GDR market would have to be approved by a special resolution of the company whose shares are being divested.

vi. The proceeds of the ADR/GDR issue raised abroad shall be repatriated into India within a period of one month of the closure of the issue.

vii. Such ADR/GDR issues against existing shares arising out of the divestment would also come within the purview of the existing SEBI Takeover Code if the ADRs/GDRs are cancelled and the underlying shares are to be registered with the company as shareholders.

viii. Divestment of existing shares of Indian companies in the overseas markets for issue of ADRs/GDRs would be reckoned as FDI. Such proposals would require FIPB approval as also other approvals, if any, under the FDI policy.

ix. Such divestment inducting foreign equity would also need to conform to the FDI sectoral policy and the prescribed sectoral cap as applicable. Accordingly, the facility would not be available where the company whose shares are to be divested is engaged in an activity where FDI is not permitted.

x. Each case would require the approval of FIPB for foreign equity induction through offer of existing shares under the ADR/GDR route.

xi. Other mandatory approvals such as those under the Companies Act, etc. as applicable would have to be obtained by the company prior to the ADR/GDR issue.

xii. The issue related expenses (covering both fixed expenses like underwriting commissions, lead managers charges, legal expenses and reimbursable expenses) for public issue shall be subject to a ceiling of 4% in the case of GDRs and 7% in the case of ADRs and 2% in case of private placements of ADRs/GDRs. Issue expenses beyond the ceiling would need the approval of RBI. The issue expenses shall be passed onto the shareholders participating in the sponsored issue on a pro-rata basis.

xiii. The shares earmarked for the sponsored ADR/GDR issue may be kept in an escrow account created for this purpose and in any case, the retention of shares in such escrow account shall not exceed 3 months.

xiv. If the issues of ADR/GDR are made in more than one tranche, each tranche would have to be treated as a separate transaction.

xv. After completing the transactions, the companies would need to furnish full particulars thereof including amount raised through ADRs/GDRs, number of ADRs/GDRs issued and the underlying shares offered, percentage of foreign equity level in the Indian company on account of issue of ADRs/GDRs, details of issue parameters, details of repatriation, and other details to the Exchange Control Department of the Reserve Bank of India, Central Office, Mumbai within 30 days of completion of such transactions.

xvi. The tax provision under Section 115 AC of the Income Tax Act 1961, which is applicable to non-resident investors for ADR/GDR offering against issue of fresh underlying shares would extend to non-resident investors investing in foreign exchange in ADRs/GDRs issued against disinvested existing shares, in terms of the relevant provisions of the Income Tax Act, 1961

xvii. Resident shareholders divesting their holdings will be subject to Capital Gain tax provisions applicable under the Income Tax Act 1961 i.e. Section 115 AC applicable for non-residents would not extend to them.

Except the above said laws there are other laws also like RBI guidelines and FDI guidelines which has to be followed strictly while dealing with Indian Depository Receipts.

CONCLUSION

Depository Receipts has undoubtedly proved itself as one of the most innovative engineered financial instruments for raising financial benefits in International capital market. The company is able to raise huge amount of foreign currency capital at a very low cost by going in for Depository Receipts. Secondly, the ADR/GDR issues enables the Indian companies to enhance its resources from international market without any loss of managerial control as ADR/GDR holders have the right to issue voting instruction by directing overseas depository to vote in a particular manner on its behalf in respect of securities. DRs has itself as a very strong tool to reduce foreign currency risk. Issue of shares in international capital market strengthens the global image of the company in view of the wide publicity of the company's product and performance which helps in great fashion in developing the export market for the company. New trends suggest the purpose of investors for investing in DRs is to diversify their portfolio.

The speedy growth of market for this innovative product will definitely lead to overcome some limitations in cross country investments, especially in developing countries like India.

Still there's strong need to identify the parameters of success in the DRs Market to avoid past fiascos in coming future. In the opinion of researcher following steps may be taken in order to enhance the mobilization of GDRs in international capital market in context with India.

Effective Pricing—Companies need to be very careful while pricing their issues keeping it within reasonable and realistic parameters as prescribed by the relevant laws and should not charge excessively high premium. According to the provisions of Depository Receipt Schemes, 2014, price of the securities issued to the foreign depository for issuing depository receipts shall not be less than price if such security issued to domestic investors.

Competent Lead Manager—Only a competent Lead Manager can design appropriate marketing strategies and structure the issue. The Lead Manager must be chosen in much advance and keeping in mind his past records of managing the similar industry. Most importantly, a Lead Manager having personal rapport would definitely provide the exact and accurate information related to the obstacles in the issue. In order to make swift launch of the DR issue, the company has to appoint a co-lead/co-manager with the issuing company/Lead Manager.

Strong Fundamentals—Only a company possessing sound and strong fundamentals tools in regard to the industry they operate with, would yield great result in extracting maximum benefits of resource in international capital market.

Perfect Timing—the GDR game is all about playing at perfect timing, when the global markets are in a bullish condition and there's no shortage of money in global market plus it must be calculated that numbers of other Indian companies should not be competing at the same time.

Updating Self about the Market Activity—The issuer company must keep themselves updated with the latest developments and trends in global and Indian capital markets. Also, one should be updated with the changing laws and regulations in order to formulate their GDRs accordingly to track global trends for future success.

Perfect sized GDR Issues—The size of the GDR issues must be appropriate neither too huge nor too small. A moderate sized GDRs must be packaged in a fashion offering optimum benefits to the international investors and smoothly absorbable in international capital markets. Most innovate and creative moderate sized packaging tends to draw larger amount of money and long-lasting relationships with investors.

Transparency—Company must heed on winning and inculcating unbreakable confidence of the investors by adopting the best policy of transparency. The company shall take care and make its investors apprise of its financial management issues. Moreover, the company must be transparent about the end uses, it intends to put the money obtained from the GDR Issue.

Most Effective Marketing Strategies and Road Shows—A successful and promising Road Show opens the doors of big and reputed investors for the company. A good Road Show is always successful in grabbing investors by projecting management, finances and future scope of the company effectively.

Prepare Market for next Issue Launch—A company must focus on providing its latest activities through various verified research data and reports or available means, even after its Issue has been completed with purpose to prepare and track the global capital market for its next issue launch in near future.

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