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American Depositary Receipts (ADRs) – By Prof. DEV D



- ADR is a stock that trades in stock exchanges in the United States. It is a dollar denominated form of equity ownership in a non-US company
- Each ADR represents a specific number of shares (one or more) in a foreign corporation
- ADRs pay dividends in US dollars
- ADRs are traded on NYSE, NASDAQ and AMEX in the United States
- ADRS were introduced in the financial markets in 1927

GLOBAL DEPOSITORY RECEIPTS (GDRS)

DEFINITION OF GDR:

Global Depositary Receipt means any instrument in the form of a depository receipt or certificate created by the Overseas Depositary Bank outside India and issued to non-resident investors against issue of ordinary shares or FCCB of issuing Indian company.

MEANING OF GDR:

A Global Depositary Receipt represents a certain number of equity shares. Though Global Depositor is denominated in dollar terms, the equity shares comprised in each Global Depositary Receipt are denominated in Rs. *For example, a Global Depositary Receipt of \$ 30 may comprise of two equity shares of \$ 15 each equivalent to Rs. 600 each, at the rate of exchange prevailing at the time of issue. (Here, \$ 1=Rs.40)*

The securities are issued by the issuing company to an intermediary called “**Overseas Depositary Bank**”. The Depositary Receipt to Foreign investors. The issue and the depository enter into a Depositary Agreement, detailing the terms and conditions of the agreement between them.

(Company Secretary, Cyber Lawyer, M.com)

The equity shares are in physical possession of another intermediary called the **“Domestic Custodian Bank”** who is an agent of the Overseas Depository Bank. The Depository and the custodian shall enter into an agreement between themselves, known as the Custodian Agreement.

NOTE: If a company wants to tap the retail investors of US, it can be done only through issue of American Depository Receipts (ADRs). However, procedure and disclosures in the case of American Depository Receipts are much more stringent than Global Depository Receipts.

SPONSORED GDR

GDR issue can be through sponsored GDR programmed or through fresh issue of shares.

Through Sponsored GDRs the existing holders of shares in Indian Companies can sell their shares in the overseas market. It is a process of disinvestment by Indian shareholders of their holding in overseas market. The concerned Company sponsors the GDRs against the shares offered for disinvestment. These shares are converted into GDRs and sold to foreign investors. The proceeds realized are distributed to the shareholders in proportion to the shares sold by them.

Thus, by sponsored GDR method, an Indian Company is able to shift its shareholding base from Indian to foreign countries, without increasing its capital.

FOREIGN CURRENCY CONVERTIBLE BONDS (FCCBS)

DEFINITION OF FCCB: Foreign Currency Convertible Bonds mean bonds issued in accordance with the Government's Guidelines and subscribed by non-resident in foreign currency and convertible into ordinary shares of the issued company, wholly or partly, based on any equity-linked warrants attached to debt instruments.

MEANING AND CONCEPT OF FCCBs: Foreign Currency Convertible bonds are unsecured borrowing. They carry a fixed rate of interest. Foreign Currency Convertible Bonds are attached with an option for conversion into a fixed number of equity shares of the issuer company. Interest and redemption price where conversion option is not exercised is payable in dollars. Interests are very low by Indian domestic standards. Foreign Currency Convertible Bonds are denominated in any freely convertible foreign currency.

FOREIGN CURRENCY EXCHANGE BONDS?

- A bond expressed in foreign currency.
- The principal and the interest of which is payable in foreign currency.

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- The issuer of the bond is an Indian company.
- The bonds are subscribed by a person resident outside India.
- The bonds are exchangeable into equity shares of another company which is also called the offered company.

It may be noted that issuing company is to be the part of promoter group of offered company and the offered company is to be listed and be eligible to receive foreign investment.

FCCB AND FCEB

Foreign currency convertible bonds (FCCBs) are issued by a company to non-residents giving them the option to convert them into shares of the same company at a predetermined price. On the other hand, foreign currency exchangeable bonds are issued by the investment or holding company of a group to non-residents which are exchangeable for the shares of the specified group company at a predetermined price.

The key difference, therefore, is while FCCB involves just one company, FCEB involves at least two companies – the bonds are usually of the parent company while the shares are of the operating company which must be a listed company.

ADVANTAGES OF FOREIGN CURRENCY CONVERTIBLE BONDS/GLOBAL DEPOSITORY RECEIPTS

- 1) The cost of raising equity funds from international markets is generally lower than the cost of domestic issues.
- 2) It implies acceptance by sophisticated western investors, which in turn would help to enhance the image of company and its product internationally.
- 3) It will broaden the shareholder base and enhance investor quality.
- 4) It enables the tapping of the international capital possible.
- 5) It is listed and traded in International Stock Exchange and Hence are free from delivery and settlement problems.
- 6) It Is generally denominated in US Dollars and hence reduces the foreign exchange rise.
- 7) Investors in euro Issues are not required to comply with a large number of complex formalities and regulations normally required for investment through domestic Stock Exchanges.
- 8) No dilution in control and management rights.

APPROVALS REQUIRED FOR ISSUING GDRs/FCCBs

1. **APPROVAL OF BOARD OF DIRECTORS:** A meeting of Board of Directors is required to be held for approving the proposal to raise money from Euro capital market. A board resolution is to be passed to approve the raising of finance by issue of GDRs/FCCBs.
2. **APPROVAL OF SHAREHOLDERS:** A special resolution under the Companies Act, 2013 is required to be passed at a duly convened general meeting of the shareholders of the Company. In case of Euro optionally convertible debentures, resolution is also required to be passed.
3. **APPROVAL OF MINISTRY OF FINANCE - IN PRINCIPLE AND FINAL:** An eligible issuing company shall make an application to the Department of Economic Affairs, Ministry of Finance, and Government of India for obtaining in-principle approval.

The Government of India will, if satisfied with the company's proposals, issue an approval in-principle granting permission to the company to mobilize foreign currency resources for a specified amount.

On completion of finalization of issue structure in consultation with the Lead Manager to the issue, the company should also obtain the final approval from the Government.

4. **APPROVAL OF RESERVE BANK OF INDIA:** The issuer company has to obtain approvals from RBI under circumstances specified under the Guidelines issued by the concerned authorities from time to time.
5. **APPROVAL OF MINISTRY OF CORPORATE AFFAIRS:** The issuer company requires approval from the Ministry of Corporate Affairs, where the convertible bonds are being issued, which after such conversion, are likely to increase the subscribed capital of the company.
6. **IN PRINCIPLE CONSENT OF STOCK EXCHANGE FOR LISTING OF UNDERLYING SHARES:** The issuing company has to make a request to the domestic Stock Exchange for in-principle consent for listing of underlying shares, which shall be lying in the custody of domestic custodian. These shares, when released by the custodian after cancellation of GDR, are traded on Indian Stock Exchanges like any other equity shares.
7. **IN PRINCIPLE CONSENT OF FINANCIAL INSTITUTIONS:** Where term loans have been obtained by the company from the financial institutions and the agreement relating to the loan contains a stipulation that the consent of the financial institutions has to be obtained, the company must obtain in-principle consent on the board terms of the proposed issue.

AGENCIES INVOLVED IN ISSUING GDRs / FCCBs

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1. **LEAD MANAGER**: The company has to choose a competent lead manager to structure the issue and arrange for the marketing. Lead managers usually charge a fee of 2 to 3 percent of the issue. The issue related to public or private placement, nature of investment, coupon rate on bonds and conversion price are to be decided in consultation with the lead manager.
2. **CO-LEAD /CO-MANAGER**: In consultation with the lead manager, the company has to appoint co-lead/co-manager to coordinate with the issuing company/lead manager to make the smooth launching of Euro Issue.
3. **OVERSEAS DEPOSITORY BANK (ODB)**: It is the bank, which is authorized by the issuing company to issue Depository receipts against issue of ordinary shares of GDR/ ADR of issuing company.
4. **DOMESTIC CUSTODIAN BANK**: This is a banking company, which acts as custodian for the ordinary shares or FCCB of an Indian company, which are issued by it. The domestic custodian bank functions in coordination with the depository bank. When the shares are issued by a company the same are registered in the name of the depository and physical possession is handed over to the custodian. The beneficial interest in respect of such shares however rests with the investors.
5. **UNDERWRITERS**: It is desirable to get the Euro Issue underwritten by banks and syndicates. Usually the underwriters subscribe for a portion of the issue with arrangements for tie-up for the balance with their clients. In addition, they will interact with the influential investors and assist the lead manager to complete the issue successfully.
6. **AUDITORS**: The role of issuer's company's auditors is to prepare the Auditors Report for inclusion in the offer document, provide requisite comfort letters and reconciliation of the issuer company's accounts between Indian GAAP/UK GAAP/US GAAP.
7. **LEGAL ADVISORS**: The issuing company should appoint legal advisors who will guide the company and the lead manager to prepare offer document, depository agreement, indemnity agreement, and subscription agreement.
8. **LISTING AGENT**: One of the conditions of Euro-issue is that it should be listed at one or more Overseas Stock Exchanges. The appointment of listing agent is necessary to coordinate with issuing company for listing the securities on Overseas Stock Exchanges.
9. **PRINTERS**: The issuing company should appoint printers of international repute for printing Offering Circular.

DOCUMENTATION INVOLVED IN ISSUING GDRs / FCCBs

1. **SUBSCRIPTION AGREEMENT**: Subscription agreement provides that lead managers and other managers agree, severally and not jointly, with the company, subject to the satisfaction of certain conditions, to subscribe for GDRs at the offering price set forth. It may provide that obligations of managers be subject to certain conditions precedent.
2. **DEPOSITORY AGREEMENT**: Depository agreement lays down the detailed arrangements entered into by the company with the Depository, the forms and terms of the depository receipt, which are represented by the deposited shares. It also sets forth the rights and duties of the depository in respect of the deposited shares and all other securities, cash and other property received subsequently in respect of such deposited shares.
3. **CUSTODIAN AGREEMENT**: This agreement is between the overseas Depository Bank and the Domestic Custodian Bank.
4. **AGENCY AGREEMENT**: In the case of FCCBs, the company has to enter into an agency agreement with certain persons known as conversion agents. These agents are required to make the principal and interest payment to the holders of FCCBs from the fund provided by the company.
5. **TRUST DEED**: In respect of FCCBs the company enters into a covenant (known as Trust Deed) with the trustee for the holders of FCCBs, guaranteeing payment of principal and interest amount on such FCCBs and to comply with the obligations in respect of such FCCBs.

ROAD SHOWS

Road shows represent meeting issuers, analysts and potential investors. Details about the company are presented in the road shows and such details usually include the following information about the company making the issue:

1. History
2. Organizational structure
3. Principal objects
4. Business line
5. Position of the company in Indian and international market
6. Past performance of the company
7. Future plan of the company
8. Competition-domestic as well as foreign
9. Financial results and operating performance
10. Valuation of shares
11. Review of the Indian stock market and economics situation.

Thus at road shows, series of information presentations are organized in selected cities around the world with analysts and potential institutional investors.

OFFERING CIRCULAR

- (i) The Offering Circular should be very comprehensive to take care of overall interest of the prospective investor. The Offering Circular for Euro-issue offering should typically cover the following contents:
- (ii) Background of the company and its promoters including date of incorporation and
- (iii) Objects, past performance, production, sales and distribution network, future plans etc.
- (iv) Capital structure of the company-existing proposed and consolidated.
- (v) Devolvement of issue proceeds.
- (vi) Financial data indicating track record of consistent profitability of the company.
- (vii) Group investments their performance including Subsidiaries, joint venture in India and abroad.
- (viii) Description of shares.
- (ix) Terms and conditions of global depository receipt and any other instrument issued along with it.
- (x) Economic and regulatory policies of the government of India.
- (xi) Details of Indian securities market indicating stock exchange, listing requirements,
- (xii) foreign investment in Indian securities.
- (xiii) Market price of securities.
- (xiv) Dividend and capitalization.
- (xv) Securities regulations and exchange control.
- (xvi) Tax aspect indicating analysis of tax consequences under Indian law of acquisition,
- (xvii) membership and sale of shares, treatment of capital gain tax etc.
- (xviii) Status of approval required to be obtained from government of Indian.
- (xix) Summary of significant differences in Indian GAAP, UK GAAP and US GAAP and expert's opinion.
- (xx) Report of statutory auditor.
- (xxi) Subscription and sale.
- (xxii) Transfer restrictions in respect of instruments.
- (xxiii) Legal matters etc.
- (xxiv) Other general information not forming part of any of the above.

GOVERNMENT GUIDELINES FOR EURO ISSUES

ELIGIBILITY: An Indian company seeking to raise foreign funds is required to obtain the prior approval of Department of Economics Affairs, Ministry of Finance, and Government of India. In some cases, Foreign Investment Promotion Board clearance is also required before the ministry approval.

An Indian company seeking Euro Issue should have a consistent track record of good performance, financial or otherwise, for a minimum period of 3 years.

LIMITATIONS ON EURO ISSUE: Global Depository Receipts/Foreign Currency Convertible Bonds issued by an Indian company shall be treated as Foreign Direct Investment in the issuing company. The aggregate of foreign investment made, directly or indirectly, through Global Depository Receipt, mechanism shall not exceed 51% of the issued and subscribed capital of the issuing company. However, the investment made through off shore funds or foreign institutional investors will not form part of the limit indicated above.

ISSUE STRUCTURE OF GDRs: Global Depository Receipt must be denominated in term of dollars and foreign Currency Convertible Bonds may be denominated in any freely convertible foreign currency. The ordinary shares underlying the Global Depository Receipt and the shares issued upon the conversion of Foreign Currency Convertible Bonds will be denominated only in Indian currency.

LISTING OF EURO ISSUES: Global Depository Receipts/ Foreign Currency Convertible Bonds issues are generally listed on Luxembourg Stock Exchange and the London Stock Exchange. The requirements for listing on Luxembourg Stock Exchange are less stringent than on the Stock Exchange like London Stock Exchange and New York Stock Exchange. The shares underlying the Global Depository Receipt to be listed on that Indian Stock Exchange where the shares of the company are listed.

TRANSFERS AND REDEMPTION: Non-resident holder of Global Depository Receipt may transfer the Global Depository Receipt or may ask the Overseas Depository Bank to redeem those receipts. In case of redemption, the Overseas Depository Bank shall request the Domestic Custodian bank to get the corresponding underlying shares released in favor of non-resident investors for being sold directly on behalf of the non-resident investor or being transferred in the records of the issuing company in the name of the non-resident investor.

ENTITLEMENT OF GDR / ADR HOLDERS TO RIGHTS AND BONUS ISSUES
A Global Depository Receipt/ American Depository Receipt holders have an entitlement to bonus shares or rights shares in a company, the company would need to issue and place ordinary shares with the Domestic Custodian Bank against which the Overseas Depository Bank would issue corresponding Global Depository Receipts/American Depository Receipts to such existing Global Depository Receipt/American Depository Receipt holders.

It may be noted that American Depository Receipt/Global Depository Receipt holders are entitled for all economic benefits but do not have any corporate benefits like the right to vote.

Have faith