CHAPTER 3

ROLE AND GUIDELINES OF GOVT., SEBI AND OTHER AGENCIES ON EURO ISSUE ACTIVITY
1 Introduction

The markets are channels through which funds flow from one market participant to another. There are three types of market participants; ultimate borrowers, ultimate lenders, and financial intermediaries. Investors attempt to accumulate wealth to alter or smooth their pattern of consumption, or to change the risks attached to their consumption or portfolios of assets. Borrowers transact to gain investable funds to consume or to alter the risks attached to their liabilities. Financial intermediaries earn a return by packaging financial assets for borrowers or lenders increasing the variety of securities directly available in the market. They can also act as brokers by arranging deals between borrowers and lenders.

In recent years government agencies and institutions have become increasingly active as intermediaries in domestic financial systems. However their stated goals are not regulatory, but redistribution of wealth or income. Private and public institution can facilitate the growth and strength of the financial system. Government agencies such as SEBI perform both regulatory and market development functions.
2  **Role of Government**

The Ministry of Finance, Department of Economic Affairs, on November 12, 1993, issued comprehensive guidelines and procedures for the issue of Foreign Currency Convertible Bonds (FCCB) and ordinary shares through the Global Depository Receipt (GDR) mechanism. Internal guidelines have been drawn to approve Euro-issues of companies approaching the Government.

The government has the following role to play with regard to euro-issues:

(i) The aggregate foreign investment made either directly or indirectly through the GDR mechanism shall not exceed 51 per cent of the issue and subscribed capital of the issuing company. This will be in addition to the maximum limit of 24 per cent equity, which can be acquired by offshore funds, foreign institutional investors, or non-resident Indian through the secondary market.

(ii) It has been clarified that the ordinary shares and Foreign Currency Convertible Bonds (FCCB) issued against GDR shall be treated as direct foreign investment in the issuing company.

(iii) The eligibility criteria under the scheme are:

An issuing company desirous of raising foreign funds by issuing FCCBs or ordinary shares of equity issues through GDR is required to obtain prior permission of the Department of Economic Affairs, Ministry of Finance, Union Government. An issuing company seeking permission shall have a consistent track record of good performance (financial or otherwise) for a
minimum period of three years, on the basis issued to the company by the Department of Economic Affairs, Ministry of Finance.

(iv) On the completion of finalisation of issue structure in consultation with the lead manager to the issue, the issuing company shall obtain the final approval for proceeding ahead with the issue from the Department of Economic Affairs.

(v) According to the scheme, there will be no capital gains tax on the shares underlying GDRs till they are redeemed. The cost of acquisition of shares underlying GDRs shall be reckoned as the cost on the date on which the Overseas Depository Bank (ODB) advises the domestic custodian bank for redemption. The price of the ordinary shares of the issuing company prevailing on the Bombay Stock Exchange (BSE) or the National Stock Exchange (NSE) on the date of the advice of redemption shall be taken as the cost of acquisition of underlying ordinary shares. Similarly, for the purpose of conversion of FCCB, the cost of acquisition in the hands of non-resident investor would be the conversion price, determined on the basis of the price of the shares on BSE or NSE, on the date conversion of FCCBs into shares. It means that the holder of GDRs or FCCBs will not be required to pay any capital gains tax on the movement in the price of shares (issued against GDRs or FCCBs) between the time these instruments are acquired and the time they are converted or redeemed. Capital gains tax will be applicable on
the movement in share prices after GDRs are redeemed or FCCBs converted into shares.

(vi) An interesting provision is that approval of GDRs and FCCBs will be subject to the understanding that the foreign currency resources raised through the issue should be mandatorily remitted to India immediately after the issue. This implies that permission to keep the more raised though GDRs abroad under a specific provision in FERA will not be ordinarily granted.

(vii) On the question of avoidance of double taxation agreement in case of GDRs, it is stipulated that the provision of double tax avoidance treaty between India and the country of residence of ODB will be applicable in the matter of taxation of income from dividends from underlying shares and interest on FCCBs. Since most of ODBs are situated in the US, the Indo-US tax avoidance agreement will be converted, the provisions of the tax treaty between India and Country of residence of the non-resident investor will be applicable.

(viii) Conversion of FCCBs into shares should not given rise to any capital gains liable to income tax in India. However transfer of FCCBs mode outside India by a non-resident investor to another non-resident investor should not give rise to any capital gains liable to tax in India. Similarly, on taxation of shares issued under the GDR mechanism, it is stated that under the
provisions of the Income-tax Act, income by way of dividend on shares, would be taxed at the rate of 10 per cent.

(ix) The issuing company is required to transfer the net dividend payment after deducting tax at source to ODB. On receipt of these payments of dividend after taxation, ODB is to distribute them to the NRI investors proportionate to their holding of GDRs, evidencing the relevant shares.

(x) All transaction of trading of GDRs outside India, among non-resident investors, will be free from any liability of income tax in India on capital gains therefrom. However, if any capital gain arises on the transfer of the aforementioned shares in India to the NRI investor, he would be liable to income-tax under the provisions of Income-tax Act.

(xi) The Guidelines are deemed to have come into force with effect from April 1, 1992. This has been done in view of the fact that Section 115AC of the Income-tax Act stood enacted as on that date and a number of Indian companies have since had FCCBs equity issues under the scheme.
3 Role of Securities And Exchange Board of India

In the SEBI Act, 1992, the development of the securities market is placed ahead of the regulation of the market and the investor protection comes ahead of both development and regulation.

If SEBI, in its wisdom believes that by prescribing such limits for capital mobilization, it is protecting the interests of the investors, or that it is giving boost to the tottering primary market, or that it regulates the capital flow in a desirable direction, it may well be said to be acting within its constitutional brief.

In its 15 years of existence, in all fairness, SEBI has made significant progress in bringing considerable maturity to the regulatory framework of the Indian capital market. Over the years, SEBI has developed regulatory codes in a variety of areas, where none existed before. These pertain to: Acquisitions and Takeovers, Bankers to Issues Debenture Trustees, Insiders. Trading Euro-issue activity, Investor Protection, Merchant Bankers, Mutual Funds, Portfolio Managers, Registrars, Stock Brokers & sub-Brokers and Underwriters. The spirit of most of these codes are essentially such that the intermediaries can operate freely in the market without violating what is expressly stated to be the dos and don’ts. In this sense, the provisions of these codes are essentially regulatory.

This is not to say that one can find no fault in the various acts of commissions and omissions of SEBI. For example, if as the press reports suggest, SEBI did suggest that companies raising capital
outside India must offer a minimum of 25 per cent to the Indian public with a view to helping the Indian primary market the move would appear inconsistent with the reduction of the 25 per cent requirement down to 10 per cent for the public offer of IT companies. Look at it this way – if a corporate wishes to mobilize capital outside India, SEBI will ask it to offer a minimum of 25 per cent to the Indian public; but if it threatens to up the ante to go and list itself outside Indian, in say NASDAQ, SEBI will be willing to bring down this requirement to 10 per cent! But such criticisms, even if legitimate, do not amount to saying that SEBI has become a controller of capital market rather than a regulator.

**SEBI proposed Price Board for new GDRs Issues**

The Securities & Exchange Board of India (SEBI) determined to have control on Euro issues by Indian companies. It is also interested in introducing a “bond concept” for new issue pricing besides a package of other measures to bring about radical changes in the primary market.

According to Mr. V H Pandaya, the Senior Executive Director of SEBI, talks have been initiated with the Union Government to bring all issues of Global Depository Receipts (GDR) within SEBI’s purview.

The logic is simple. Since after unlinking, shares issued against the GDRs will come under its control. That apart, SEBI is also insisting there should be some amount of parity between the disclosures made by domestic companies in India and abroad.
SEBI may put cap on Euroissues Discount Level

The Government is concerned at the recent practice of leading Indian companies offering high discounts in the prices of their Euro-issues to woo the foreign investors. It has asked Securities and Exchange Board of India (SEBI) to examine whether any cap can be imposed on the level of discount.

Already SEBI is carrying out a review of the pricing mechanism of the GDR issues and it has been found that many of the front ranking companies are hiking their respective discounts, thereby giving a big price advantage to the foreign subscribers as against the Indians within the country.

Besides, such discounts invite an unjustified arbitrage opportunity to cross border operators. The FIIs in particular, may always book a profit in India on stock acquired abroad. Such arbitrage operation assumes relevance in view of the fact that when seen on a one-year horizon – it is only the Indian stock market, which is booming whereas the other markets across the globe are on skid.
4 Role of Merchant Bankers and other Intermediaries:

There are a number of parties involved in the global issues. It is with the whole-hearted co-operation and sincere efforts of these parties; that the global issue are made successful. Each party has got a well defined and definite role to play and the global issue may turn down to be a failure if there is default on the part of any of the intermediaries involved. The role of these intermediaries could be explained as follows:

i. Merchant Bankers

Merchant banking services are heavy competitive business activities and to get business, merchant banking department, division, cell or bureau or company have the requisite skills of marketing and salesmanship to ensure that the opportunities once found is not lost without obtaining mandate from the client. Therefore a merchant banker has got to be a social person with mixing nature and temperament of liking others.

The expected role of merchant bankers is to grow in number with the growing requirements of financial services for the corporate section and the community as a the lobal context. The important role in the global context is that merchant bankers are conductry the management of capital issuer in different fashion. Arranged besides being the distribution of the securities.
ii. **Lead Manager**

Lead Manager is responsible for the marketing of the Euro Issue, which is considered as a specialised activity. He advises the type of security to be issued i.e. Equity, Bonds, Convertible Bonds and rate of interest price of the security etc.

Besides, he appoints the co-managers to the issue liaisoning agent to co-ordinate with the Issuer Company and other intermediaries.

In short, the following aspects are decided in consultation with the lead manager public or private placement.

- Nature of investment i.e. GDR/FCCB
- Coupon rate on bonds
- Conversion price
- Advisors
- Printers, etc.

iii. **Depository for the Issue**

He is an overseas agent of the company who issues the depository receipt to the investors in lieu of shares allotted to him. However, the physical possession of the shares rest with the custodian and the ownership of the shares rests with the investors. If the investors with to cancel the GDRs the depository advises his domestic custodian against delivery of GDR to release the number of shares underlying that particular GDR in favour of the investors.
iv. **Domestic Custodian**
The domestic custodian acts in coordination with the depository. The shares are issued in the name of the depository and the physical possession of the shares is given to the custodian. However, the investor are the beneficial owners of the shares when the GDRs are cancelled the depository entrusts the custodian to release the shares for trading in Indian capital market.

v. **Legal Advisors**
He helps in the preparation of the offer documents, depository agreement, and indemnity agreement and subscription agreement.

vi. **Co-Managers**
Co-manager helps the lead manager in fulfilling his obligations to the Issuer Company.

In many countries domestic financial markets are inadequate. Borrowers and investors in countries with inefficient or incomplete capital markets are often forced to use foreign markets to meet financial needs.

- Borrowers and lenders from countries with fully developed financial systems can also choose to transact in foreign markets. One of the most important motives is the financial support of direct foreign investment. One unique element of this decision to finance or invest abroad is that foreign financial contracts are denominated in a foreign
currency. As a consequence the market for the exchange of currencies is a basic and unique element of the international financial system.

A second characteristic that differentiates international from domestic transactions is that some market participants are operating outside their national boundaries. Many domestic financial intermediaries transact directly with foreigners and the financial sectors of the most countries are heavily international by virtue of the extensive branch networks of major financial institutions.

While international organizations do not generally perform a regulatory function, several other institutions actively redistribute wealth from developed to developing countries.

The international financial system fulfills two major roles. First, it serves to integrate the separate domestic systems. As a result the international financial system has grown to accommodate large and more numerous domestic financial systems. Second, it acts as a system in its own right by supporting financial transactions that are supranational. Increasing numbers of borrowers and investors prefer to operate outside of domestic financial markets or located in countries where financial markets are limited or non-existent.
5 Role of Stock Exchanges

(i) The stock market is supposed to encourage savings by providing households with an additional instrument which may better their risk preferences and liquidity needs. In well-developed capital markets, share-ownership provides individuals with a relatively liquid means of sharing risks in investment projects. Both the endowment risk (such as health hazards) and the rate of return risk (such as those due to the volatility of stock returns) can be shared via instruments of the well-developed capital market. For example, rate of return risk can be reduced by diversifying portfolios through the securities market. But the effect of all these on savings is very ambiguous. Even theoretically, it can be shown that under certain conditions, people will save less. With constant relative risk aversion utility, the response of saving is negative if the risk aversion co-efficient is above 1. Additionally Devereux and Smith (1991) have shown that when countries share endowment risk via international capital markets, the saving can be lower.

(ii) There are three ways by which the stock market might affect consumer demand and hence the savings rate. The first, which is closely identified with the life cycle model of consumer behaviour, emphasis's the effect of changes in wealth. The second uses the stock market as proxy measure of optimism or pessimism (So called ‘consumer sentiment’). The third way is
via the greater availability of consumer credit in a not developed capital market.

(a) Any estimate of stock market effects must rest on an evaluation of the importance of wealth on consumer behaviour. If one accepts the view that consumption reflects an attempt to maximise intertemporal utility subject to the constraint of total available resources, current earned income is a poor measure of that constraint. Individuals can both save for and borrow against the future and they receive income claims from sources other than currency production – for example inheritance, gift and capital gains. So the capital gains should have an impact on consumption via the wealth effect, in the long run. However, soon complication may arise due to the peculiarities of the share markets and the corporate stock holdings. Corporate stock holdings are highly concentrated among the rich, and one might well be dubious that unrealised capital gains and losses have a constraining influence on the consumption decision of such individuals. This is true even in the developed countries. For example, a study by Kul Bhatia (1972) showed that in the US, 51 per cent of all stock market assets were held by those in top 1 per cent of the income distribution. In addition, capital gains and losses on such assets are highly transitory and only a small portion is actually realised. Therefore the net impact of the stock market on consumption is less straightforward. An empirical study by Bosworth (1975) on the US stock market could not come to a definite conclusion on the impact of capital gains, via wealth effect, on consumption.
(b) This second approach suggests rather indirect role of stock market on consumer demand. It uses stock prices as a proxy for consumer sentiments. Stock prices change for a variety of reason; they may decline because individuals’ expectations of total future income have declined, because they expect a smaller share of this income to accrue to owners of corporations or because rates of return on other assets have risen. When stock values decline because of lower expectation of income, assuming consumption is not an inferior good, consumption can be expected to fall in current and future periods. This is the straightforward income effect. But this hypothesis does not hold much water because stock prices hardly reflect only the movements in consumer sentiment. The empirical evidence (Bosworth 1975) is not significant either.

This channel influences savings by easing the terms and availability of consumers credits. Capital markets channel funds from the households that save to those that disserve. So, the development of capital market allows easier accesses to reedit and relaxes the income constraint on consumption spending. This gives rise to massive growth in consumer loans. This is particularly true for installment loans for cash and other consumer durable and credit card loans. This increasing access to easy credit gives a boost to consumer durable and credit card loans. This increasing access to easy credit gives a boost consumerism and impact of a capital market development on savings is perverse in this case. Empirical results show that inverse correlation exists between households borrowing and savings rates in most OECD countries since the 1980s (Bhunall-Wignall and Browne 1991).
(iii) The effect of the stock market on savings through the interest rate is probably the most controversial of all effects. One standard argument follows: Lack of competition among financial intermediaries widens the margins charged by them. Financial repression and imperfect competition keep the interest rate paid to the savers below that prevailing under percent capital markets. With the development of the capital markets, the interest rate rises and this rise in the interest rate induces higher savings and hence too higher growth. This view was due to the so-called Stanford School and was put forward by McKinnon (1973) and Shaw (1973). Study by Fry (1980) on seven developing countries including India and Burma (with 196 data) concludes that there exists a positive relationship between real rate of interest and the national savings rate. The World Development Report 1989 published data which suggested that countries with higher real interest rate tend to have a higher growth rate. Another study, which supports the strong positive interest elasticity of saving, is by Boskin (1978), but this study has been criticised for using very non-standard data series. On the other hand, studies by Giovannini (1983, 1985) question the conclusions of these studies especially those by Maxwell Fry, Giovannini could not establish Fry’s the 1970s data in lieu of the 1960s data used by Fry. Other empirical evidence also does not support the simple positive correlation between private savings and interest rate. This is true for a wide

This comes as no surprise because even theoretically the argument of McKinnon and Shaw can be criticized on the following grounds:

(1) The personal propensity to save from current income depends upon two forces pulling in opposite directions, namely the substitutional and income effects. As a result of the interest rate hike, there is negative substitution effect on current consumption plus an income effect from higher interest payments in the future period. The sign of this income effect on current consumption will depend upon whether the individual intended to be a saver or borrower before the interest rate change. Give a negative substitution effect and an indeterminate income effect, the net effect on current consumption and hence saving is indeterminate.

Moreover, if current income falls relative to expected future income a rise in interest rates can be associated with a fall in savings. This often happens when interest rate deregulation occurs during rapid inflation and is accompanied by a macro-economic tightening that results in a sharp decline in employment and income.

(2) A large swing in interest rates can lead to consumption of wealth, especially when non-interest income is declining. This is true especially for small savers who can react to increases in interest
rates by liquidating real assets and foreign exchange holdings in order to invest in bank deposits and in an effort to maintain their standard of living, consuming not only the real component of interest income but also part of its nominal component corresponding to inflation. This tendency is often reinforced by money illusion, i.e. the inability to distinguish between nominal and real incomes.

(3) Whether or not higher interest rates in the formal sector following the development of capital market will increase aggregate savings depends on the losers and gainers from this process. To the extent that the personal sector finances the investments of the corporate sector, which in developing countries is often highly geared, of higher interest rates may reduce corporate retained earnings.

(4) The behaviour of households may be quite different from the assumed in conventional theory. For instance, they may be targeting a certain level of future income or wealth. Higher interest rates may then lower household savings by making it possible to attain the target with fewer current savings.

Thus interest rate increases are not a reliable instrument for raising domestic savings. As Cho and Khatkhate (1989) conclude: "Financial reform whether comprehensive and sweeping or measure and gradual does not seem to have made any significant difference to the saving and investment activities in the liberalised
economies. It was believed until recently that removal of repressive policies would boost saving. The survey in this paper of this consequence of reform does not reveal any systematic trend or pattern in regard to saving (and also investment). This study lend support to the by now well acknowledge conclusion that decision to save is determined by several factors and the relationship between savings and real interest rates is at base ambiguous."

THE mainstream argument that the entry of foreign portfolio investors will boost a country’s stock market and economy does not seem be working in India. The influx of FIIs failed to invigorate the Indian stock market. The supposed linkage effects have not worked in the way the mainstream model predicted. Instead there a has been an increased uncertainty and skepticism about the stock market in India. The findings of this study do not support the view that influx of FPI leads to economic development.

As far as beneficial effects of FPIare concerned, it is supposed to work via the stock market route. At a theoretical level also the proposition that a vibrant stock market affects economic development is not beyond criticism. According to one school of thought stock markets under certain conditions may actually inhibit economic development. Even in advanced countries with developed capital markets, stock markets are likely to do more harm than good to the real economy. The supposed positive contribution of stock markets (encouragement of savings and more efficient allocation of invisible resources), hardly materialise
in practice. On the other hand, there is strong evidence that the negative features of stock markets have played a crucial role in putting the capital market based economies of the US and the UK at a competitive disadvantage vis-à-vis the bank based economies of Japan and Germany.

One of the main reasons behind this deleterious role of stock markets emerges due to the dilemma posed by modern capital markets. Modern capital markets try to reconcile the social need for investment with the preference of individual investors for risk, return and liquidity. In this process, secondary markets open up prospects for speculations. Speculation leads to a situation where the players indulge in outguessing the market in foreseeing changes in short-term financial ratios. This turns the secondary market in some kind of a casino where people speculate on other people's speculation. This seriously hinders long-term investment and thereby affects economic growth.

Also in stock market based economy individual investors, neither have the means nor the incentive to monitor and control corporate management. Market discipline is often exercise through hostile take-over. Generally, it has been found that take-over are disruptive and wasteful. More importantly, since markets try to value the enterprise largely on the basis of short-term financial, performance, take-over threats create pressure and incentives for the management to think short-term. Also it is widely believed that to discipline corporations, product market competition is much superior to competition in ownership.
Role of Foreign Financial Institutions

Various factors have played important role in the process of global integration of India’s equity market such as (i) the evolution of foreign investor’s perception of equity market risk, (ii) structural and regulatory changes in the international investment process, (iii) tailoring of financial instruments and (iv) development in industrial countries markets. But there are various inherent problems of integration with global market. Sharp increase in capital inflows poses inherent risks as observed in Asia and Latin America. Rise in capital inflows, particularly portfolio inflow, by FIIs may result in (i) inflationary pressure due to rapid expansion of money and credit and (ii) appreciation in the real effective exchange rate. There are possibility of deterioration in the current account and a deleterious effects in the banking sector.

(1) Volatility and outflows: There is also increasing possibility of abrupt and sudden outflows of capital if the inflows are of a short-term nature as in the case of portfolio inflows of FIIs. The recent experience of reversal of private capital flows observed in Mexico during the later part of 1994 due to sudden change in FIIs investment sentiment provides a vivid illustration of such risks. As there was recovery in world economy, including the economy of the US, rise in interest rate and tightening of capital market condition in industrial countries, competition between emerging markets and world market intensified leading to increasing prospects of reversal in the emerging markets where the inflows are mostly of short-term nature. These unfavourable financial
conditions plus domestic political shocks in Mexico in March 1994 set off an economic chain reaction in that country. The decision to devalue and then to float the peso created fear about Mexico’s ability to service its foreign currency debt in the minds of international investors and so the FIIs began to retreat.

Due to the Mexican crisis, the share of emerging economies in total international equity placements declined to less than 28 per cent during first nine months of 1995 compared with 37 per cent in 1994. The Mexican financial crisis triggered self-off by FIIs across all emerging markets. As result, emerging equity markets has a difficulty year in 1995. The International Finance Corporation’s investable Composite Index which tracks prices of more than 1,600 Scripps of 26 emerging markets was down by 10.3 per cent in US dollar terms at the end of the year. The year 1995 began with some of the largest monthly declines in the history of IFC indexes following heavy losses in December 1994 mainly due to anxiety about Mexico’s crisis as well as the collapse of Baring Brothers. The impact of the Mexican crisis during December 1994 was also felt in India. The portfolio flows of FIIs to India slackened in the first art of 1995-96. During January-December 1995, net portfolio investment by FIIs was only $ 1,191 million. The amount collected by Indian companies from GDR issues fell to $304 million in 1995. Mumbai SE Sensex, which touched the peak of 4,631 in September 1994, glided down till the last quarter of 1995.
If FIIs lose confidence in an economy for its weak balance of payments and others, then they retreat. This is what happened in Mexico in 1994 and recently in Thailand in July-August 1997. The current account deficit and depreciation of both led to withdrawal of FIIs and the resultant slump in Thailand stock market. Because, usually, FIIs take into account some specific risks in emerging markets such as (I) political instability and economic mismanagement (ii) liquidity risk and (iii) currency movement. Currency movement can have a dramatic impact on equity returns of FIIs, a depreciation having an adverse effect. The withdrawal of FIIs from ASEAN countries led to large inflow of funds to FIIs to India for which equity market in India is buoyant at present.

Thus, short-term flows including portfolio flows of FIIs to inherently unstable and increases volatility of the emerging equity market. They are speculative and respond adversely to any instability either in the real economy or in financial variables. Investment in emerging markets by FIIs can at times be driven more by a perceived lack of opportunities in industrial counties than by sound fundamentals in developing counties including India. Emerging stock markets of India and other developing countries have a low, even negative correlation with the stock markets in industrial nations. So, when the latter goes down, FIIs invest more in the former as a means to reduce overall portfolio risk. On the other hand, if there is boom in industrial countries, there may be reverse flow funds of FIIs from India and other developing countries. Of course, there is pull for international
private portfolio investment of FIIs participation in equity markets in India and other emerging markets. However, to the extent, FIIs view emerging markets as a single-asset class, shocks in one country or region can also be transmitted to other merging markets producing volatile collapsing share price behaviour (Aitken 1996; Richards 1996).

The number of FIIs registered with SEBI increased from only 10 in January 1993 to 350 by the end of January 1996 and by December 1996, the number increased to 427. Net investments by FIIs, which was only US$ 4.3 million in 1992-93. Suddenly increased to $1,634.1 million in 1993-94 and further to $2,035.6 million in 1995-96. Total portfolio investment in Indian capital market through FIIs. Euro equities offshore funds and others increased from $8 million on 1991-92 to $3,581 million in 1994-95, (Economic Survey, 1995-96). The amount collected by Indian companies from GDR issues was $240 million in 1992, $510.90 million in 1993, $3,116 million 1994 and fell to $304 million in 1995. The fund raised by bond issue by Indian companies by October 1996 is around 1,035 million. Due to this global integrate of India’s equity market, FIIs are playing major role in India. On an average, 130 of the 427. FIIs registered have been active in any given month during 1996-97 even though almost two-thirds of purchases and sales have been accounted for by only 25 FIIs.
7 Guidelines for Euro Issue

A scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) was notified by Government of India in November, 1993. Revisions/Modifications in the operative guidelines for Euro-issues are announced from time to time.

On the basis of the periodic review and assessment of the current situation, the following Euro-issue guideline, in continuation of the Notification of November, 1993, shall come into effect for approvals granted on, or after the date of issue of these guidelines, in suppression of all previous guidelines on the subject.

Track record

i. An issuing company seeking permission for raising foreign funds by Euro-issues having a consistent track record of good performance (financial or otherwise) for a period of three years shall be allowed to issue GDRs/FCCBs.

ii. In view of the importance of the infrastructure projects, and the need to encourage equity financing of such projects, the three-year track record requirement would be relaxed in case of companies seeking GDR/FCCB issues to finance investments in infrastructure industries such as power generation, telecommunication, petroleum exploration and refining, ports airports and roads.
Approvals

iii. Euro-issues shall be treated as direct foreign investment (subject to extant polices governing direct foreign investments) in the issuing company. Accordingly, a company which is implementing projects not predominantly contained in Annexure-III of the New Industrial Policy of 1991, or a company which undertakes a project contained in Annexure-III but whose direct foreign investment after the proposed Euro-issue is likely to exceed 51 per cent of the post issue subscribed capital, will need to obtain prior FIPB clearance before final approval to the Euro-issue is given by the Finance Ministry.

Number of issues

iv. Some restrictions had been imposed previously on the number of issues that could be floated by an individual company or a group of companies during a financial year. There will henceforth be no restrictions on the number of Euro-Issues to be floated by a company or a group of companies in a financial year.

End use: GDRs

v. In relaxation of earlier guidelines, GDR end uses will include
   — financing capital goods imports;
— capital expenditure including domestic purchase/installation of plant, machines, equipment and buildings and investments in software development;
— prepayment or scheduled repayment of earlier external borrowings;
— investments abroad where these have been approved by competent authorities;
— equity investment in JVs/WOSs in India.

vi. However, investments in stock markets and real estate will not be permitted.

vii. Within this framework, GDR raising companies will be allowed full flexibility in deploying the proceeds.

viii. Upto a maximum of 25 per cent of the total proceeds may be used for general corporate restructuring, including working capital requirements of the company raising the GDR.

ix. However, Banks, FIs, and Non-Banking Finance Companies (NBFCs) registered with RBI will be eligible for GDR issues without reference to the end use criteria mentioned in paras 7 to 10 above with the restriction that investments in stock markets and real estate will not be permitted.

x. A company shall be required to specify the proposed end-use of the issue
proceeds at the time of making their application, and will be required to submit quarterly statement of utilisation of fund of funds for the approved end-uses, duly certified by their auditors.

**End-use: FCCBs**

xi. Currently, companies are permitted to access foreign capital market through Foreign Currency Convertible Bonds for restructuring of external debt which helps to lengthen maturity and soften terms, and for end-use of funds which conform to the norms prescribed by the Government for External Commercial Borrowings (ECB) from time to time. In addition to these, not more than 25 per cent of FCCB issue proceeds may be used for general corporate restructuring including working capital requirements.

**FCCB Pricing**

xii. FCCBs are available and accessible more freely as compared to external debt, and the expectation of the Government it that FCCBs should have a substantially finer spread than ECBs. According debt instruments (ECBs).

xiii. Companies will not be permitted to issue warrants alongwith their Euro-issue.
Repatriation of proceeds
xiv. These companies may retain the proceeds abroad or may remit funds into India in anticipation of the use of funds for approved end-uses.

Lidity
xv. Both the in principle and final approvals will be valid for three months from the date of their respective issue.

Review
xvi. The policy and guidelines for Euro-issues will be subject to review periodically.

Internal Guidelines on Euro Issue
Internal guidelines have been finalised on April 20, 1993, which are applicable to manufacturing of all companies and discourage financial companies to float issues in Euro-market. The salient feature of the guidelines are as under:

(i) The investment plans will have to be clearly specified. The purpose of issue can no longer be vague or for “corporate purposes/working capital requirement”.

(ii) A minimum issue size should be $ 20 million and the maximum size pegged at $ 100 million. The limits for raising founds in specific sectors are higher $ 500 million for power, $ 500 million in shipping, etc.
(iii) Euro-convertibles will be permitted, but companies will be allowed access to the Euro-market only once in a year. The amount raised via the Euro-route will be restricted to 50 per cent of the post-issue market capitalisation.

**Revised Guidelines on Euro-issues**

Recently, on April 27, 1994, the Ministry of Finance decided to review the Euro-issue policy after every three months. The underlying idea is to maintain control over proposals of Euro-issues keeping in view the balance of payments situation in India Accordingly new guidelines were issued in May 1994. Text of revised guidelines is given in Annexure II.

Salient feature of new guidelines are given as under:

i. For the present it is proposed to follow a restrictive policy towards Foreign Currency Convertible Bonds since such Bonds form part of the country’s external debt till their conversion into equity. However, companies will be allowed on merits to issue FCCBs as part of a programme of restructuring of external debt which helps to lengthen maturity and soften terms.

ii. Euro-Issues will be treated as direct foreign investments. Accordingly, a company contained in Annexure-III of the New Industrial Policy of 1991 whose direct foreign investment after a proposed Euro-Issue is likely to exceed 51%, or which is
implementing projects not predominantly contained in Annexure-III, would need to obtain prior FIPB clearance before final approval for the Euro Issue is given by the Finance Ministry.

iii. For the purpose of ensuring that as many companies as possible avail of this scheme, only one issue per company in a financial year will be permitted with a minimum gap of twelve months between two issues by the same company and not more than two issues will be permitted for any group of companies in a financial year.

iv. Both the in-principle and final approvals will be valid only for three months from the dates of their respective issues.

v. Requests for retention of the Issue proceeds abroad will be considered on specific applications, for import of capital goods, retiring foreign currency debts, capitalising Indian joint ventures, etc. and projects abroad.

vi. GDR issues would be permitted only for the following end-use to be incurred within one year from the date of issue:

i) Financing capital goods import;

ii) Financing domestic purchase/installation of plant, equipment and buildings;

iii) Prepayment or scheduled repayment of earlier external borrowing;
iv) Making investments abroad where these have been approved by competent authorities.

v) A margin of 15% the total proceeds of an issue for other general corporate restructuring uses.

I. Companies would be required to submit quarterly statements of utilisation of funds duly certified by their auditors.

II. The policy and guidelines for Euro Issues will be subject to review every three months

**Recent Change in Guidelines:-**

The Government of India recently passed fresh guidelines for Euro Issue, which could be summarised as under:

1. A company could only come out with one issue in a financial year and there should be a gap of at least 12 months between two issues.

2. Group companies cannot come out with more than 2 issues in a single financial year.

3. The funds raised through the Euro issue would be treated as Direct Foreign Investment (DFI).

Accordingly, a company referred in Annexeure – III of the new Industrial Policy of 1991 whose direct foreign investment after a proposed Euro issue is expected to exceed 51% or which is implementing projects, not predominantly contained in Annexeure – III, would need to obtained in Annexeure – III, would need to obtain prior FIBP clearance before final approval for the Euro Issue is given by the finance Ministry.
4. Request for retention of the issue proceeds abroad will be considered on specific application for import of capital goods, retiring foreign currency debts, capitalising Indian Joint Ventures and projects abroad.

5. The policy and guidelines would be reviewed after every 3 months. However, no cap was given on the amount to be raised through Euro Issue.

6. GDR issues would be permitted only for the following end use to be covered within one year from the date of issue:

   i) Financing capital goods import
   
   ii) Financing domestic purchase/installation of plant, equipment and buildings
   
   iii) Prepayment or scheduled repayment of earlier external borrowing
   
   iv) Making investments abroad where these have been approved by competent authorities
   
   v) A margin of 15% of the total proceeds of an issue for other general corporate restructuring uses.
8. Procedural Requirements for Euro Issues:

(i) A company intending to go global has to pass a Board Resolution for raising additional equity by floating GDRs/FCCBs in the Euro Market. Thereafter, a special Resolution has to be passed by the shareholders in the General market of section 81 companies Act.

(ii) In principle clearance has to be obtained from the government by furnishing full details in the prescribed forms.

(iii) The company has to choose a competent lead manager to structure the issue and arrange for the marketing. The decision will be taken on the following points:

(a) Public or Private placements
(b) Tentative issue price
(c) GDRs/FCCBs
(d) Coupon rate on bonds
(e) Conversion price

(iv) Further the company has to select other intermediaries such as co-managers/underwriters, overseas Depository Bank, Domestic custodian, solicitors, auditors and Printers.

(v) Other Aspects

(a) Documentation:

Principle documents involved are Prospectus, Depository Agreement between issuing company and Depository, and Custodians. Subscription Agreement between investor and underwriters.
(b) **Issue of Shares:**

The Prospectus has to be filed with SEBI for their information and records. Company has to issue the shares and registered in the name of the depository and lodged physically with the domestic custodian. The overseas Depository Bank then issues the GDRs to the underwriters for placement with the investors.

(c) **Listing**

Indian GDRs can be listed on the Luxembourg Stock Exchange, American Stock Exchange (AMEX), New York Stock Exchange or the national Association of Securities Dealers Automated Quotations (NASDAQ).

However, Indian GDRs are preferably listed on the Luxembourg Stock Exchange because of the minimum of formalities for listing and the Stock Exchange admission and relatively lower listing fees. Recently, looking at the performance of the Indian industry, the LSE has liberalized its listing rules for Indian GDRs. With this East India Hotel’s $40 M GDR issue became the first Indian issue to be listed on the London Stock Exchange.

The following issues will be decided by the issuing company with the Lead Manager to the issue namely:

a) public or private placement;

b) number of Global Depositary Receipts to be issued;

c) the issue price;
d) the rate of interest payable on Foreign Currency Convertible Bonds; and

e) the conversion price, coupon and the pricing of the conversion options of the Foreign Currency Convertible Bonds.
9 Eligibility for Euro Issue

For the purposes of the requirements of the eligibility criteria the issue structure of the company proposing to make issue of GDRs shall satisfy the following requirements:

1. Eligibility for issue of convertible bonds or ordinary shares of issuing company. — (1) an issuing company desirous of raising foreign funds by issuing Foreign Currency Convertible Bonds or ordinary shares for equity issues through Global Depository Receipt is required to obtain prior permission of the Department of Economic Affairs, Ministry of Finance, Government of India.

2. An issuing company seeking permission under sub-paragraph (1) shall have a consistent track record of good performance (financial or otherwise) for a minimum period of three years, on the basis of which an approval for finalising the issue structure would be issued to the company by the Department of Economic Affairs, Ministry of Finance.

3. On the completion of finalisation of issue in consultation with the Lead Manager to the issue, the issuing company shall obtain the final approval for proceeding ahead with the issue from the Department of Economic Affairs, Ministry of Finance.

Explanation — For the purpose of sub-paragraph (2) and (3) “issue structure” means any of the requirements, which are provided in paragraphs 5 and 6 of this Scheme.

4. The Foreign Currency Convertible Bonds shall be denominated in any freely convertible foreign currency and the ordinary shares of an issuing company shall be denominated in India rupees.
5. When an issuing company issues ordinary shares or bonds under this scheme, that company shall deliver the ordinary shares or bonds to a Domestic Custodian Bank who will, in terms of agreement, instruct the Overseas Depository bank to issue Global Depository Receipt or certificate to non-resident investors against the shares or bonds help by the Domestic Custodian Bank.

6. A global Depository Receipt may be issued in the negotiable form and may be listed on any international stock exchanges for trading outside India.

7. The provisions of any law relating to issue of capital by an Indian company shall apply in relation to the issue of Foreign Currency Convertible bonds or the ordinary shares of an issuing company and the issuing company shall obtain the necessary permission or exemption form the appropriate authority under the relevant law relating to issue of capital.
Issue Structure

The structuring of an Euro Issue is really a tough task. The company has to decide whether it has to go for private placement with FIIs, or go for GDR or Euro convertible Bonds. The dilution of promoters holding as a result of private placement of GDR issue or by way of conversion in ECB issue is a matter of paramount importance for the management. Many companies also resist Euro convertible issues with a conversion option to be exercise after lock-in period at a predetermined price fixed at the time of closure of issues. Some companies prefer ECB issue even at a higher coupon rate but without put option clause. The companies with low equity base and high reserves built-up over a long period would like to structure Euro Issues without much dilution of their Equity holding pattern. Many permutations and combinations are being worked out. Many companies are toying with an idea to structure ECB issue with a conversion price ruling at the time of conversion with a discount of 20% to 30%. Some companies may like to structure Euro bond issues with warrants enabling investors to convert such warrants into limited equity shares without significant dilution of its existing holding. How overseas investors will react to such proposals is yet to be seen.

Following detailed discussions with several International Investment Banks, the Board of Directors has recommended to proceed with the International Offer and seeks shareholders approval for it on the terms set out in the said Special Resolution.
The company has received an “in principle approval” for the International Offer from the Government of India. The detailed terms and conditions for the International offer will be determined in conjunction with the International Offer will not exceed an aggregate face value of 15% of the authorised share capital. Since the pricing of the offering cannot be decided except at a later stage, it is not possible to state the price or the exact number of securities or shares to be issued and hence an enabling resolution in wide terms is being passed to give adequate flexibility and discretion to the Board to finalise the terms in consultation with the lead managers and underwriters or such other authority or authorities as need to be consulted including in relation to the pricing of the issue which will be a free market pricing and may be at a premium or discount to market price in accordance with international practice.

The issue price of securities issued pursuant to the international offer will be determined by the Board at the time of the offering depending on the prevailing conditions. Securities issued pursuant to the international Offer would be listed on the Luxembourg Stock Exchange and/or London Stock Exchange or any other Exchanges outside India and may be represented by Depository Receipts or other securities outside India.

The Special Resolution seeks to give the Board powers to issue and market any securities issued pursuant to the International Offer, including for instance the power to issue such securities in such trance
or trenches, at such time or times and at such price or prices as the Board may in its absolute discretion deem fit.

Under the said Special Resolution consent of the shareholders is being sought pursuant to the provisions of Section 81 and all other applicable provisions of the Companies Act, 1956 and in terms of the provisions of the Listing Agreement executed by the company with the various stock exchanges in India where the company’s securities are listed.

Section 81 of the companies Act, 1956 provides inter alia, that when it is proposed to increase the issued capital of a company be the allotment of further shares, such further shares shall be offered to the existing shareholders of the company in the manner laid down in Section 81, unless the shareholders in a General Meeting decide otherwise.

The Listing Agreement referred to above provides, inter alia, that the company, in the first instance, should offer all shares and debentures to be issued by the company for subscription, pro-rata, to the equity shareholders unless the shareholders decide otherwise in General Meeting.

The said Special Resolution will, if passed, have the effect of allowing the Board on behalf of the company to issue and allow securities otherwise than on a pro rata basis to the existing shareholders.
The Board of Directors believes that the proposed International offer is in the interest of the company.

Your Directors, therefore, recommended the resolution for your approval. None of the directors of the company is, in any way, concerned or interested in the accompanying Special Resolution.

1. Issue Structure of the Global Depository Receipts — (1) A Global Depository Receipt may be issued for one or more underlying shares or bonds held with the Domestic Custodian Bank.

2. The Foreign Currency Convertible Bonds and Global Depository Receipts may be denominated in any freely convertible foreign currency.

3. The ordinary shares underlying the Global Depository Receipts and the shares issued upon conversion of the Foreign Currency Convertible bonds will be denominated only in Indian currency.

4. The following issues will be decided by the issuing company with the Lead Manager to the issue, namely:
   (a) public or private placement;
   (b) number of Global Depository Receipts to be issued;
   (c) the issue price;
   (d) the rate of interest payable on Foreign Currency Convertible Bonds; and
   (e) the conversion price, coupon, and the pricing of the conversion options of the Foreign Currency Convertible Bonds;
5. There would be no lock-in period for the Global Depository Receipts issued under this scheme.

In 1992 Reliance and Grasim found it extremely difficult to sell their issues. Reliance in fact sold at a steep 17 per cent discount.

Times were still tough in the first half of 1993. Hindalco's GDR issues are simple, had warrants attached to them for free. Similar Essay Gujarat sold its convertible bonds with a put option which ensured investors guaranteed returns at a high price for the issues.

Gradually the Indian stock markets have recovered from the scam. Today there is a tremendous enthusiasm for India and almost every big investor wants to have Indian papers in his portfolio.
11 Listing
Listing Norms for Indian GRDS in London Stock Exchange

Looking at the performance of the Indian industries in the 1st half of the year the LSE has liberalized its listing rules for Indian GDRs looking at the investors demand in London, the London Stock Exchange has relaxed its listing guidelines for Indian companies planning to tap the international capital market by making issues of Global Depository Receipts (GDRs). Now the India's companies need only submit audited accounts that are not more than 18 months old. The accounts as per the Indian company law are acceptable with the condition that a statement reflecting the differences between the Indian and the UK GAAP has been enclosed.

Prior to this listing at the LSE was not consider advisable because of stringent disclosure requirements and high listing fees. Also listing of the GDRs at the LSE required it the underlying shares also should have been registered in the exchange. But the listing rules have been amended in August, 1994 and this condition is no more required. However, the disclosure requirements have been relaxes to a considerable extent. Unlike the Indian Stock Market where the trading is order-driven i.e. based on client’s order, the brakes executes it at a reasonable prices, SEAQ is Market Maker driven. The Market Making is highly competitive and Prices are determined. So as to balance the demand and supply.
Listing fees has been made competitive. As per the new listing rules initial listing fee is £4000 and annual listing fee is £2000. Besides the dealing cost is nominal because there is no stamp duty in case of overseas securities transaction, and the transactions are dealt net of commission. There is a professional team in London Stock Exchange who looks at GDRs and Euro Bonds and the listing is normally granted in 48 hours.

Warrants/FCDs/PCDs or any other financial instruments issues on a preferential basis will not be transferable in and manner for a period of five year from their date of allotment. Similarly, the shares acquired by conversion of otherwise would also remain locked in for a period of five years from the date of their allotment.

Action on any resolution passed at a meeting of shareholders of a company granting consent for preferential issues of any financial instrument shall be completed within period of three month from the date of passing of the resolution. If such a resolution is not acted upon within the same period, a fresh consent of the shareholders will have to be obtained and the relevant date referred to in explanation above will relate to the new resolution.

In case of every issue of shares/warrants/FCDs/PCDs or other financial instruments, the statutory auditors of the issuer company must satisfy that the issue of said instruments is being made in accordance with the requirements contained in these guidelines.
Copies of the certificate shall also be laid before the meeting of the shareholders convened to consider the proposed issue.

 Preferential allotments, if any, to be made in favour of Foreign Institutional Investors (FIIs) shall also be governed by the guidelines issued by the Union Government SEBI/RBI on the subject.
Listing At Global Stock Exchange

Listing on London, New York and other leading international stock exchanges confer enormous benefits to a company in its globalisation pursuits. Stock of the advantages of global listing are given below:-

One of the major disadvantages to Indian companies seeking listing on international stock exchanges is the high standard of disclosure requirements for listing. The disclosure requirements for listing in London and New York are quite stringent and the accounting requirements of a company have to be geared to meet the requirements overseas.

Owing to the sharp variation in accounting practices and disclosures, companies have to prepare the accounts and reports strictly in accordance with international practices. This is a major deterrent to the Indian companies, which are used to minimal disclosures in their annual reports.

Pursuant to paragraph 6 of the Scheme the Global Depository Receipts issued under this scheme a may be listed on any of the Overseas Stock Exchanges, or Over the Counter Exchanges or through Book Entry Transfer Systems prevalent abroad and such receipts may be purchased, possessed and freely transferable by a person who is a non-resident within the meaning of section 2(q) of the Foreign Exchange Regulation Act, 1973, subject to the provisions of that Act.
Ceiling
The ordinary shares and Foreign Currency Convertible Bonds issued against the Global Depository Receipts shall be treated as direct foreign investment in the issuing company. The aggregate of the foreign investment made either directly or indirectly though Global Depository Receipts Mechanism shall not exceed 51 per cent of the issued and subscribed capital of the issuing company. However, the investments made through Offshore Funds or by Foreign Institutional Investors will not form part of the limit laid down in this paragraph.

Transfer and Redemption
The following provisions of the Scheme as contained in paragraph 7 thereof regarding transfer and redemption of GDRs and FCCBs and transfer of the underlying shares, are to be noted:

1) A non-resident holder of GDRs may transfer those receipts, or may ask the Overseas Depository Bank to redeem those receipts. In the case of redemption, Overseas Depository Bank to redeem those receipts. In the Domestic Custodian bank to get the corresponding underlying shares released in favour of the non-resident investor for being sold directly on behalf of the non-resident, or being transferred in the books of account of the issuing company in the name of the non-resident.

2) In case of redemption of the GDRs into underlying shares a request for the same will be transmitted by the Overseas Depository Bank
to the Domestic Custodian Bank in India, with a copy of the same being sent to the issuing company for information and record.

3) On redemption, the cost of acquisition of the shares underlying the GDRs shall be reckoned as the cost on the date on which the overseas Depository Bank advises the Domestic Custodian bank for redemption. The price of the ordinary shares of the issuing company prevailing in the Bombay Stock Exchange or the National Stock Exchange on the date of the advice of redemption shall be taken as the cost of acquisition of the underlying ordinary shares.

4) For the purpose of conversions of FCCBs, the cost of acquisition in the hands of the non-resident investors would be the conversion price determined on the basis of the basis of the price of the shares at the Bombay Stock Exchange or the National Stock Exchange, on the date of the conversion.
The Depositary and Custodian

The Depositary

As noted earlier, a depositary is a person to whom securities or instruments are entrusted for safekeeping. He acts as a trustee because securities or instruments are lodged with him in trust. In an Euro issue of GDRs a depositary is appointed to hold the deposited shares represented by the GDRs for the benefit of the holders thereof. It is usually an overseas bank which acts as a depositary. Thus, the depositary is an overseas agent of the company who issues the depositary receipts to the investors in lieu of shares allotted to him and physical possession of shares held by custodians the beneficial interest in respect of which rests with the investors. When these GDRs are traded the same are delivered to the depositary that changes his records regarding the ownership of GDRs. When an investor wants the cancellation GDRs, the depositary advises his domestic custodians against delivery of GDR to release the number of shares underlying that particular GDR in favour of the investors. The investor can thus sell those shares to Indian investors.

The Scheme defines the expression “Overseas Depositary Bank” as a bank authorised by the issuing company to issue Global Depositary Receipts against
The Custodian
The overseas depositary appoints an Indian bank or a financial institution as custodian to receive and hold on its behalf share certificates in respect of shares underlying the GDRs. A custodian is an agent of the company but he functions in coordination with the depositary. The issuer company issues the shares in the name of the depositary and the physical possession of the shares is given to the custodian. The beneficial interest lies with the investors. One receipt of shares the custodian advises the depositary to issue the GDRs to the respective investors. On cancellation of GDR when the custodian receives instructions from the depositary, he releases the shares for trading in Indian capital markets.

The Scheme defines the "Domestic Custodian Bank" as a banking company which acts as a custodian for the ordinary shares of foreign currency convertible bonds of an Indian company which are issued by it against global depositary receipts or certificates"

Voting Rights
The GDRs as seen earlier are not shares; they are instruments representing equity shares of the issuer company. The holders of GDRs are, therefore not the company's shareholders (members) who alone are entitled to attend and vote at general meetings in terms of section 87 of the companies Act. The underlying shares representing GDRs are held by the Depositary on behalf of the holders of GDRs. The Depositary is therefore, entitled to vote at general meeting of the company.
While Indian Law does not allow the issuing company to enter into an agreement with a shareholder prohibiting exercise of this voting rights, the international law on the matter is different and permits a company to do so. The Depositary invariably enters into an agreement with the company undertaking to vote in respect of the shares underlying the GDRs in the specified manner. A standard clause incorporated in the agreement in this regard is as under:

"Holders of GDRs will have no voting rights with respect to the Deposited Shasited Shares. The Depositary will not exercise any voting rights in respect of the deposited shares unless it is required to do so by law. If so required, the depositary will (subject to receipt from the company of an opinion from the Company’s legal counsel that the Depositary is required by law so to do and that in doing so the Depositary will not be liable to any shareholders of the Company), at the direction of the board of directors of the company or give a proxy or power of attorney to vote the Deposited Shares in favour of a director of the company or other person or vote in the same manner as those shareholders designated by the board of directors of the Company but, in the absence of receipt from the Company of an opinion from legal counsel as aforesaid, the Depositary shall not be obliged to exercise any voting rights in accordance with the directors of the board of directors of the Company and shall have no liability to the Company or any Holder for any action taken or not taken, as the case may be, pursuant to this Condition. A valid corporate decision of the Company will bind the Depositary and the Holders"
There is a view that a GDR holder is beneficially interested in the underlying shares to which his GDR specifically relates and there is no way in law by which he can be deprived of this right to ask the bank, in the name of which the relevant shares may be registered, to vote according to his instructions in general body meetings of the company. There is a constructive trust or obligation in the nature of a trust; and the shareholder, who is admittedly entitled to the dividends distributed by the company in respect of the shares in question, may call upon the bank concerned to attend the meetings and vote in accordance with his directions.

The Supreme Court has explained the right of the beneficial owner of shares where shares have been transferred to him by their previous owner but have not been registered in his name by the company yet. Where the holder of a share whose name is entered in the register of members hands over his shares with blank transfer forms duly signed, the transferee would not be able to claim the rights of a member as against the company concerned until his name is entered in the register of members. [Balkrishna Gupta v Swadeshi Polytex Ltd. (1985) 58 Comp Cas 563 (SC)]. Of course, between the transferor and the transferee, certain equities arise even on the execution and handling over of a trustee on behalf of the transferee. These equities, however, do not touch the company, and no claim by the transferee whose name is not in the register of members can be made against the company, if the transferor retains the money in his own hands and fails to pay it to him. The right of a transferee is only to call upon the company to register his name and no more. No right arise till such
registration takes place. Thus where share are transferred and the name of the transferee is not yet entered in the register of members, the transferor is in the position of a constructive trustee. [Howrah Tradina Co Ltd. v CIT (1959) 29 Comp Cas 282].

The position of a GDR holder is not materially different from that of a transferee who has not got the company’s register of members rectified for inclusion of his name. The underlying shares are held for his benefit by the custodian bank. If his right to vote is denied on the ground that he has not exercised his option for redemption of the GDR and the formal acceptance of his ownership of the underlying shares, the bank in the name of which the shares are registered cannot be stopped from voting in its own right as the registered member. Any fetter on that right would be void. The company is not concerned with the accountability of the bank of the GDR holder in this regard.
13 Critical Study

SEBI may be one of the top regulatory authorities of India but often it finds itself in litigation. Following is the text of Mr. Dharmishta Raval's - Executive Director (Legal Deptt.) interview that highlights the weaknesses and strengths.

- One often finds that SEBI's actions or decisions are challenged in the courts. Why is it so?

Our decisions are challenged on the grounds that we do not have the powers to take a particular action. For instance in the HLL case dealing with insider trading, they challenged our decisions arguing that the Act did not provide us with powers to award compensation to UTI, who had complained that its interest were hurt by HLL's action. Incidentally the courts have not granted a stay against the SEBI orders but at times have admitted that there is a lacunae in the SEBI act. It is important to address them.

SEBI's inundated with complaints with investor. What can be done to ensure speedier disposal of these complaints?

I feel that we need a system of mediation, conciliation and arbitration for dealing with crime relating to capital markets. If a case where an investor is asking for refund of his money takes an indefinite time, its amounts to injustice and loss of faith in the system. Such cases need not be disposed off quickly for which we need an alternate mechanism.

For better application of Securities Laws, we need special judges, stay order do not help investors much in these cases.

-Could SEBI play more active role in disposing investors complaints?
We need to first decide whether SEBI should play the role of a regulatory body alone or should also provide judicial remedy and award compensatory damages.

-Do you think the current regulations amply secure the interest of investors?

Firstly, we think we need to identify a regulator for a specific area without having a multiplicity of authorities. Today, an investor is confused as to whom to approach. This would help to also avoid situation like that of vanishing companies where we needed and created a coordination committee between SEBI and DCA. In the case of plantation companies, by the time a regulator was identified, a large number of companies had mushroomed and taken investors for a ride.

-How far did the justice D. R. Dhanuka address these issues?

The Dhanuka Committee had recommended the need for identifying a regulator. Besides, to make regulations more effective it also recommended disgorgement of profits and losses avoided. That is, the committee recommended that in case of illegal profits at least three times the profit should be taken away. This would act as an effective deterrent.

Disgorgement of profits is a common practice in some common markets. The RBI has such a provision. We are only asking that it should be legally permissible for SEBI too.

It is also important that self-regulatory organization like association of mutual funds of India, association of Merchant bankers of India have statutory status. This move would help to instill the concept of self-regulation.