

Corpsec Hotline

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VOTING OF ADRS/GDRS ISSUED BY BANKS TO BE SCRUTINIZED

The Reserve Bank of India ("RBI") has, on **February 5, 2007**, issued a circular ("Circular"), requiring all banks who have issued American Depositary Receipts ("ADRs") or Global Depositary Receipts ("GDRs") to provide an undertaking stating that such banks shall not take cognizance of (i) any voting by the overseas depositary, who is the shareholder of the bank and has issued the depositary receipts to investors ("Investors") on the basis of the shares held by it ("Depositary"), if such voting is in contravention of the depositary agreement entered into by the relevant bank and the Depositary ("Depositary Agreement") and amend the terms of the Depositary Agreements; and (ii) the terms of the Depositary Agreement should not be amended without the bank obtaining the prior approval of the RBI in this regard.

Further, the RBI has directed the banks who have issued ADRs or GDRs to furnish a copy of the Depositary Agreement entered into by them with the RBI.

Euro Issue Guidelines

The issuance of ADRs and GDRs and by Indian issuers are regulated by the Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme which was notified by the Government of India on November 12, 1993 and guidelines issued thereunder by the Ministry of Finance from time to time (the "Euro Issue Guidelines").

The requirement for the appointment of the Depositary emanates from the Euro Issue Guidelines and banks, like any other issuer, enters into the Depositary Agreement with the Depositary. Since the Depositary is a shareholder of the issuer company, the Depositary Agreement has a provision as to voting rights on the shares held by the Depositary. Generally such a provision would state that the Depositary would not exercise voting rights in respect of the shares held by them or they would do so as directed by the Board of Directors of the issuer. However, there are certain instances when the Investors (persons holding the ADRs or GDRs) have the right to direct the Depositaries to vote as per the Investor's instructions.

Rationale behind the Circular

Under the Banking Regulation Act, 1949 ("Banking Act"), no shareholder in a bank can exercise voting rights of more than 10 per cent irrespective of their shareholding. Therefore, even if a person has 51 per cent in a bank, such person cannot vote beyond 10 per cent.

The Circular seems to have been issued in order to check and ensure that no person, who is a holder of shares and is a holder of ADRs in a bank can indirectly exercise voting rights over and above the limits stipulated under the Banking Act.

Implications

One implication of this move by RBI would be that RBI would be able to monitor if there is any breach of the provisions of the Banking Act. However, the other implication is that the banks (who have issued ADRs or GDRs) would not be able to revise the Depositary Agreements without the prior approval of the RBI.

The Depositary Agreement, although rarely amended, governs the terms of the relationship between the bank and the depositary and consequently has a lot of terms, which are purely commercial and are not in relation to voting. Any RBI approval for the amendment of the Depositary Agreement may take a substantial time to obtain thereby causing delay and possible rejection of the proposal.

The actual implications of this Circular will become clearer over time.

Source: *RBI Circular dated February 5, 2007.*

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You can direct your queries or comments to the authors

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