

Between the lines...

February, 2015

Key Highlights...

- ✓ *New regulations for issue and listing of securities in foreign capital markets*
- ✓ *Easing of security norms for ECB*
- ✓ *Supreme Court clarifies liability of directors*
- ✓ *Reforms to insurance laws*

I. New regulations for issue and listing of securities in foreign capital markets

The Ministry of Finance has notified that the issuance of depository receipts by Indian companies shall henceforth be regulated by the newly-drafted Depository Receipts Scheme, 2014 and the old 1993 Scheme for Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipts Mechanism) shall stand repealed.

The new Scheme empowers Indian companies (whether listed or unlisted, private or public or any other issuer or person holding permissible securities which has not been specifically prohibited from accessing the capital market or dealing in securities) to issue depository receipts in a foreign jurisdiction. Such foreign jurisdiction should be a member of the Financial Action Task Force (FATF)

and its securities regulator should be a member of International Organization of Securities Commissions (IOSCO). The issuance may be by way of a public offering of depository receipts or through a preferential allotment or Qualified Institutional Placement (QIP). The holders of permissible securities may also transfer permissible securities to a foreign depository for the purpose of the issue of depository receipts (with or without the approval of issuer of such permissible securities), through transactions on a recognized stock exchange, bilateral transactions or by tendering through a public platform.

Depository receipts can be issued against any permissible securities which include securities as defined in the Securities Contracts (Regulation) Act, 1956. All permissible securities must be in dematerialized form. The aggregate of permissible securities which may be issued or transferred to foreign depositories for issue of depository receipts, along with permissible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such permissible securities under Foreign Exchange Management Act, 1999 (FEMA). The permissible limit of foreign investment can be increased with the approval of the shareholders of the company.

The Scheme allows for both sponsored and unsponsored depository receipts to be issued on the back of permissible securities. Unsponsored receipts can be issued on the back of listed permissible securities if the depository receipts give the holder the right to issue voting instructions and are listed on an international exchange.

The voting rights should be exercised by the foreign depository in respect of underlying securities and the depository may take instructions from the receipt holders. The shares of a company underlying the depository receipts shall form part of public shareholding if the holder of the securities has the right to issue voting instructions and the depository receipts are listed on an international stock exchange.

Permissible securities shall not be issued to a foreign depository at a price less than the price applicable to a corresponding mode of issue of such securities to domestic investors.

There are no end-use restrictions on the deployment of proceeds other than those prescribed under FEMA.

On the date of issue of the 2014 Scheme by Ministry of Finance, there are 34 permissible jurisdictions: Argentina, Australia, Austria, Belgium, Brazil, Canada, China, Denmark, European Commission, Finland, France, Germany, Greece, Hong Kong, Iceland, Ireland, Italy, Japan, Republic of Korea, Luxembourg, Mexico, The Netherlands, New Zealand, Norway, Portugal, Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States of America.

The new Scheme is applicable from December 15, 2014.

Source:

http://finmin.nic.in/the_ministry/dept_eco_affairs/capital_market_div/DepositoryReceiptsScheme2014.pdf

VA View

With the new regulations, private equity and venture capital funds which have invested in Indian companies can exit their investments by selling shares in foreign capital markets, without having to go through the IPO route in India. Furthermore, the regulation paves the way for unlisted companies to raise funds in overseas jurisdictions.

II. Easing of security norms for external commercial borrowings

Under the extant External Commercial Borrowing (ECB) guidelines, the choice of security to be provided to the overseas lender / supplier for securing ECB is left to the borrower. The Reserve Bank of India has now decided that AD Category-I banks may allow creation of charge on immovable assets, movable assets, financial securities and issue of corporate and / or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised / raised by the borrower, subject to satisfying themselves that:

- ✓ the underlying ECB is in compliance with the extant ECB guidelines
- ✓ there exists a security clause in the Loan Agreement requiring the ECB borrower to create charge, in favour of overseas lender / security trustee, on immovable assets / movable assets / financial securities / issuance of corporate and / or personal guarantee, and
- ✓ No objection certificate, wherever necessary, from the existing lenders in India has been obtained.

For creation of charge on immovable assets, the following conditions have to be met:

- i. Such security shall be subject to provisions contained in the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000.
- ii. The permission should not be construed as a permission to acquire immovable asset (property) in India, by the overseas lender / security trustee.
- iii. In the event of enforcement / invocation of the charge, the immovable asset / property will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to liquidate the outstanding ECB.

With regards to creation of charge on movable assets, it must be noted that in the event of enforcement/invocation of the charge, the claim of the lender, whether the lender takes over the movable asset or otherwise, will be restricted to the outstanding claim against the ECB. Encumbered movable assets may also be taken out of the country.

For creation of charge over Financial Securities, the following conditions have to be met:

- i. Pledge of shares of the borrowing company held by the promoters as well as in domestic associate companies of the borrower will be permitted. Pledge on other financial securities, viz. bonds and debentures, Government Securities, Government Savings Certificates, deposit receipts of securities and units of the Unit Trust of India or of any mutual funds, standing in the name of ECB borrower/promoter, will also be permitted.
- ii. In addition, security interest over all current and future loan assets and all current assets including cash and cash equivalents, including Rupee accounts of the borrower with AD Category-I banks in India, standing in the name of the borrower/promoter, can be used as security for ECB. The Rupee accounts of the borrower/promoter can also be in the form of escrow arrangement or debt service reserve account.
- iii. In case of invocation of pledge, transfer of financial securities shall be in accordance with the extant FDI/FII policy including provisions relating to sectoral cap and pricing as applicable read with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000.

For issue of corporate guarantee, a copy of Board Resolution for the issue of corporate guarantee for the company issuing such guarantee, specifying name of the officials authorized to execute such guarantees on behalf of the company or in individual capacity should be obtained. Specific requests from individuals to issue personal guarantee indicating details of the ECB should be obtained. Such security shall be subject to provisions contained in the Foreign Exchange Management (Guarantees) Regulations, 2000.

Source: <http://rbidocs.rbi.org.in/rdocs/notification/PDFs/55APD010115.pdf>

VA View

The Reserve Bank of India has liberalized the security norms for ECB borrowers by expanding the pool of assets to be provided as security. The pool now includes movable assets, security interest over all current and future loan assets and all current assets, debentures, Government Securities, units of mutual funds etc., standing in the name of ECB borrower.

III. *Supreme Court clarifies the liability the directors*

In the case of Sunil Bharti Mittal v. Central Bureau of Investigation (CBI), the Supreme Court of India has unequivocally stated that senior corporate executives would not be held criminally liable for acts and actions of the company unless there was concrete evidence to show his complicity.

The matter reached the apex court by way of an appeal from an order of a Special Judge of CBI, who stated that there was enough material to proceed against certain persons in connection with granting of certain telecom licenses. Specifically, it was noted that the Chairman-cum-Managing Director of Bharti Cellular Limited and the Director in Sterling Cellular Limited represented the directing mind and will of their respective companies and his state of mind is the state of mind of the companies. The court took cognizance of the case and issued summons to various persons, including the Directors. The Directors thereafter challenged the order before the apex Court.

The Supreme Court held that in case of acts of companies, an individual can only be accused if there is a categorical provision in the statute making such a person vicariously liable or there is enough material to attribute the alleged acts of criminality to the said person.

Source: <http://judis.nic.in/supremecourt/Chrseq.aspx>

VA View

The Supreme Court has clarified that directors and the shareholders cannot be made vicariously liable in criminal matters unless there is strong evidence to the contrary or there is a categorical provision in the statute. The judgment will allay concerns among corporate leaders regarding misuse of judicial process without sufficient legal justification.

IV. Reforms to Insurance Laws

The Union Cabinet had approved the promulgation of the Insurance Laws (Amendment) Ordinance 2014 to amend the Insurance Act, 1938, in accordance with the Insurance Laws (Amendment) Bill 2008 as reported by the Select Committee of the Rajya Sabha, and for suitably introducing it in the Parliament in the next session for consideration and passing.

The Ordinance has increased the permissible foreign equity investment cap in an Indian insurance company from 26% to 49%. However ownership and control must rest with Indian party. The Ordinance also permits foreign re-insurers to open branches in India, albeit only for re-insurance business.

The concept of health insurance business has been brought in. Health insurance contracts would mean contracts for providing sickness benefits or medical, surgical or hospital expense benefits, whether inpatient or out-patient travel cover and personal accident cover.

The amendment gives the responsibility of appointing insurance agents to insurers and Insurance Regulatory and Development Authority ("IRDA") to regulate their eligibility, qualifications and other aspects. An insurance agent cannot act as such for more than one life insurer, one health insurer, one general insurer and one of each of the other mono-line insurers. Appointment of principal agents, chief agents and special agents for transacting insurance business and selling policies through multilevel marketing schemes has been prohibited.

Source: <http://www.egazette.nic.in/RecentUploads.aspx>

V. Tidbits

1. The Securities and Exchange Board of India has amended the Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations, 2014 to include Core Investment Companies (CICs) in the infrastructure sector, Asset Finance Companies (AFCs), and Infrastructure Finance Companies (IFCs) registered with Reserve Bank of India within the ambit of domestic venture capital undertakings.

Source: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1420013017635.pdf

2. The Reserve Bank of India has, vide A.P. (DIR Series) Circular No.62, amended the extant Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) Regulations, 2000 by extending the facility of remittance of salary (currently available to an employee on deputation to

a branch / subsidiary / joint venture in India of a foreign company) also to a group company of such foreign company in India including a 'Limited Liability Partnership' as defined in the LLP Act, 2008.

Source: <http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=9509&Mode=0>

3. The Ministry of Corporate Affairs has clarified in the Companies (Accounts) Amendment Rules, 2015 that the rules pertaining to consolidation of financial statements shall not apply to a company having subsidiary or subsidiaries incorporated outside India, but this exemption is only for the financial year commencing on or after 1st April, 2014.

Source: www.mca.gov.in/Ministry/pdf/Amendment_Rules_2015_19012015.pdf



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