investor anxiety and preparations for a flood of new shares expected to enter the market in coming weeks.

Flood Of New Offerings Expected

A Chinese engineering company June 1, 2006, offered the first IPO since the lifting of the ban, listing on the Shenzhen exchange. The Bank of China, which recently went public with a major listing in Hong Kong, has already announced plans to present the flagging exchanges with its IPO, set to be the largest in mainland history, with 20 billion yuan (U.S.$2.5 billion) of A shares to be made available.

Stephen Green, senior economist with Standard Chartered Bank in Shanghai, said the lifting of the IPO ban illustrates that China is ready to move its securities markets to the next level.

"The challenge now is to normalize the market," said Green. "Getting new stuff on the boards is a critical development."

For years, China's stock exchanges have been plagued by problems. Primarily, investor confidence has remained critically low because of a lack of open access to company information and other decision-making tools.

The CSRC's reforms have included requiring companies to provide detailed financial statements to investors and to undergo regular independent audits.

INDIA

Guidelines Set For Foreign Firms To Issue Indian Depository Receipts

By Reuben Chacko and Ruetveij Pandya, of Nishith Desai Associates, Mumbai. The authors may be contacted by E-mail at reuben@nishithdesai.com and ruetveij@nishithdesai.com.

The Securities and Exchange Board of India ("SEBI") issued guidelines on April 3, 2006, paving the way for the issuance of Indian Depository Receipts ("IDRs"). The guidelines enabling the issuance of IDRs were introduced by way of an addition of new Chapter VI A in the SEBI (Disclosure and Investor Protection) Guidelines, 2000 (the "IDR Guidelines").

A Brief History Of IDRs

The history of IDRs can be traced back to an amendment brought about to the Companies Act, 1956 by way of the introduction of Section 605-A in 2000, which envisaged that certain rules would be framed by the Department of Company Affairs ("DCA") in relation to IDRs. Four years hence, the DCA finally issued the Companies (Issue of Indian Depository Receipts) Rules, 2004 (the "Rules") on February 23, 2004 *(see WSLR, July 2004, page 26)*. The Rules contemplated that SEBI would issue guidelines stipulating conditions for the issuance of IDRs, which it finally issued on April 3, 2006. The IDR Guidelines came into effect from April 3, 2006, and seek to supplement the Rules.

IDR Guidelines

As is the case with any depository receipts mechanism, the IDR Guidelines contemplate that a company incorporated outside India can issue IDRs through a domestic depository against the underlying equity shares of the issuing company, which are kept with a custodian in the home country.

The main aspects of the IDR Guidelines are examined below:

Eligibility For Issue Of IDRs

The IDR Guidelines stipulate certain eligibility criteria that are in addition to the eligibility criteria set out in the Rules. The most important of these is the requirement that the issuing foreign company has to be listed in its home country. The two additional criteria are more consequential in nature to the first: these are a good track record with respect to compliance under the foreign issuer's respective securities market, and that the issuer should not have been prohibited by any regulatory authority from issuing securities.

Implications: The criterion that requires the issuer to be listed in its home country seems to be quite stringent. This is especially so in light of the fact that the kind of companies which likely will want to list in India are likely to be small- and mid-capitalization foreign companies which are familiar with Indian markets or have promoters of Indian origin and are likely to be in emerging sectors such as technology, pharmaceuticals, automotive components, etc., looking for a better valuation than they would be likely to get in their home countries or looking for a lower cost of compliance.

Further, many companies looking to issue IDRs are likely to do so because they want to "flip" their current structure and would like to make the Indian company the parent company, with the global operations under the Indian company, and this Indian company could then be listed to capture the value of the global operations.

Investors

It has been clarified that Non-Resident Indians and Foreign Institutional Investors cannot invest in IDRs unless they have obtained the approval of the Reserve Bank of India ("RBI"). The minimum application amount for an IDR issue is Rs.200,000 (approximately U.S.$4,500 at current rates).

Further, an IDR issue can be subscribed only by Qualified Institutional Buyers, and Indian companies investing in IDRs cannot exceed the investment limits, if any, prescribed under their respective applicable laws.

Implications: This means that individuals will not be able to buy IDRs, which is a setback to individuals who might wish to participate in this new instrument.

Interestingly, IDRs are not automatically fungible, which means that investors will require regulatory approvals to convert IDRs into the underlying shares.

Implications: The fact that automatic fungibility has been disallowed is a setback for investors, who will not be able to access the underlying security without the permission of the authorities in India.

Disclosure Requirements For IDR Issues

The IDR Guidelines provide an option for filing the draft prospectus through public filing or through a confidential filing; interestingly, this option is not currently available for domestic companies accessing the capital markets. The filing of both the draft and the final prospectus has to be made through a merchant banker registered with SEBI, and a copy of the final

prospectus also has to be filed with the Registrar of Companies at New Delhi.

Implications: The fact that SEBI and the main stock exchanges (the Bombay Stock Exchange Ltd. and the National Stock Exchange Ltd.) are located in Mumbai, and only one filing has to be made with the Registrar of Companies at New Delhi, is a minor irritant and should not be an impediment.

General Information

In addition to a long list of disclosures and information which needs to be provided, the name, address and contact information of the overseas custodian bank needs to be provided, along with the address of its office in India.

Implications: Whether intended or not, this seems to suggest that the overseas custodian bank has to have an office in India.

The IDR Guidelines stipulate that the capital raised from the issue of IDRs has to be transferred to a separate domestic bank account.

Implications: The above requirement seems to suggest that the issuer has to open a bank account in India and the issue proceeds have to be transferred to the same. As per the current laws, any foreign person seeking to open a bank account in India requires the prior permission of the RBI. It normally takes around three to four weeks to obtain such an approval. However, since the opening of a bank account for the issuance of IDRs is uncharted territory, there is no estimation that can be provided as to the time that the RBI might take in granting such an approval.

Foreign Investment And Exchange Controls Of The Country Of Incorporation

As per the IDR Guidelines, information relating to the foreign investment laws and the exchange control regulations of the country of incorporation of the issuer or where the underlying equity shares are listed should be set out.

Financial Information

As per the IDR Guidelines, a report of the statutory auditor on the financial results and the status of the foreign company issuing the IDRs for the five financial years preceding the issue of the prospectus is to be provided. Such information should be in Indian Rupees in addition to the home country currency, and has to be prepared according to Indian generally accepted accounting principles ("Indian GAAP"), International Financial Reporting Standards ("IFRS"), or U.S. GAAP. If the financial information is prepared according to IFRS or U.S. GAAP, then such information has to be accompanied by a reconciliation statement vis-à-vis Indian GAAP, and the IFRS or U.S. GAAP results have to be audited by a professional accountant or a certified public accountant or the equivalent in accordance with International Standards on Auditing.

Further, the domestic depositary is required to prepare a report which has to be certified by a chartered accountant practicing in India, and such report has to be for the five financial years preceding the issue. This seems to be quite an onerous responsibility for a depositary.

The IDR Guidelines also mandate that, in case the proceeds of the issue are used for investing in other entities, then the names and addresses of such entities and the financial reports as stated above will be required to be furnished for such entities.

Implications: The requirement for the disclosure of an investee company seems to be quite a stringent stipulation, since in many cases the issuer company may not have ascertained the particular entity in which it will be investing funds, and in some situations such information, especially financial reports, etc., may be confidential, either due to commercial considerations or statutory requirements.

Basis Of Issue Price

The basis of pricing IDRs will need to be disclosed in the prescribed format and shall have to contain, among other things, information such as earnings per share for the last three years, price/earnings pre-issue, minimum return on increased net worth required to maintain pre-issue earnings per share, *etc.*

The said basis of the issue price is conditional upon the premise that the projected earnings are not used as a justification for the issue price in the prospectus, and that the accounting ratios disclosed in the prospectus should support the basis of the issue price.

Other Information

The issue of IDRs will be subject to the provisions of the SEBI (Disclosure and Investor Protection) Guidelines, 2000 ("DIP Guidelines"), except for Chapter VI of the DIP Guidelines.

The additional disclosure requirements cover the customary disclosure of information which, among other things, includes information relating to industry, business, details of the issuer, subsidiaries and associates of the issuer, management's discussion and analysis, litigation, information about the IDRs, management of the issuer, *etc.*

The IDR Guidelines also prescribe the requisite information and contents to be disclosed for an abridged prospectus for an IDR issue.

Listing Agreement

As per the Rules, the issuer is required to obtain an in-principle listing permission from one or more stock exchanges having nationwide trading terminals in India. Currently only the Bombay Stock Exchange Ltd. and the National Stock Exchange Ltd. have nationwide terminals; therefore, these stock exchanges are the only ones to qualify under this requirement.

In light of the above, and in line with the stipulations for domestic companies listing their securities, the SEBI has, along with the IDR Guidelines, also issued a Listing Agreement which will have to be entered into between the issuer and the respective stock exchanges on which the IDRs are to be listed. The agreement contains various stipulations and requirements of ongoing disclosures, filings, conduct, corporate governance, *etc.*, which have been prescribed.

Conclusion

The IDR route is attractive for small- and mid-capitalization foreign companies which are familiar with Indian markets or have promoters of Indian origin. Typically, these companies will be

based in the United States or Southeast Asia. With the cost of compliance increasing for companies that want to be listed or to raise further capital in the United States and other markets, listing in India may be an attractive option for foreign companies that view India as a potential market.

Since the IDR Guidelines have only just recently been introduced, it will take some time for the dust to settle and for a clearer picture to emerge of the IDR scenario in India.

TAIWAN

Voting Procedures Modified For Offshore Foreign Institutional Investors

By Lihuei Mao, of Lee and Li, Taipei. The law firm may be contacted by E-mail at attorneys@leeandli.com.

The Regulations Governing Investment in Securities by Overseas Chinese and Foreign Nationals provide that, when an offshore foreign institutional investor (FINI) holds shares in a Taiwanese company which issued shares to the public, in order to exercise its voting rights, it should, unless otherwise provided by law, appoint a Taiwan agent or representative to attend the shareholders' meetings and vote on its behalf.

In an interpretation issued in January 2005, the Financial Supervisory Commission (FSC) described circumstances under which a FINI need not appoint a Taiwan agent or representative to attend meetings and vote on its behalf.

However, on February 3, 2006, the FSC cancelled its January 2005 interpretation and issued a new interpretation stating the circumstances under which a FINI need not appoint an agent in order to exercise its voting rights.

According to the new interpretation, an FINI may exercise its shareholder voting rights in the following ways:

- If a FINI holds fewer than 300,000 shares, it may choose not to appoint a representative to attend shareholders' meetings, and will thus waive its voting rights. However, if it wishes to vote at a meeting, it may use one of the following methods: 1) appoint a Taiwan agent or representative to attend the meeting; 2) vote in writing or electronically in accordance with the Company Act; or 3) appoint an agent for stock affairs that complies with the provisions of the Criteria Governing Handling of Stock Affairs by Public Companies, to vote as its proxy; but the appointment letter must contain detailed voting instructions for each motion.
- If a FINI holds 300,000 or more shares, it must attend shareholders' meetings, but it may opt to do so in any of the following ways: 1) by appointing a Taiwan agent or representative to attend; 2) by authorizing its Taiwan agent or representative to appoint a person other than themselves to attend, but the appointment letter must contain detailed voting instructions for each motion; 3) by voting in writing or electronically in accordance with the Company Act; or 4) by appointing an agent for stock affairs that complies with the Criteria Governing Handling of Stock Affairs by Public Companies, to vote as its proxy, but the appointment letter must contain detailed voting instructions for each motion.

TAIWAN

Investments In Offshore Funds Made Subject To New Conditions

By Lihuei Mao, of Lee and Li, Taipei. The law firm may be contacted by E-mail at attorneys@leeandli.com.

According to Article 54 of the Regulations Governing Securities Investment Trust Funds, a privately placed trust fund managed by a securities investment trust enterprise (SITE) must comply with the relevant provisions in the fund's securities investment trust agreement, and with the requirements set forth by the Financial Supervisory Commission (FSC). Privately placed trust funds may invest in offshore funds not approved by or registered with the FSC.

On February 17, 2006, the FSC issued an order requiring that such offshore fund meet the following conditions:

- It may not invest in gold or commodities.
- The percentage of the offshore fund invested in Mainland China securities and red-chip shares may not exceed the percentage set by the FSC pursuant to Article 23 Paragraph 1 Item 3 of the Regulations Governing Offshore Funds.
- The fund management institution must exist for at least one year, be registered with its local regulatory authority, and have no record on file of being penalized by its regulatory authority within the past two years.
- Assessment of the offshore fund's fair value, sufficient to serve as a basis for valuation, must be made on a regular basis.

The following requirements must also be complied with:

- The trust agreement of the privately placed fund must expressly provide that "the fund may invest in offshore funds (including hedge funds) not approved by or registered with the Financial Supervisory Commission of the Executive Yuan."
- The investment memorandum must include the disclosure that "criteria for the selection of offshore funds that have not been approved by or registered with the Financial Supervisory Commission of the Executive Yuan include fund type, investment strategy, level of risk, past fund performance, valuation method, and the level of experience of the fund management institution and fund managers."
- Relevant risk information must be disclosed on the cover of the investment memorandum, such as "sub-funds invested in by this fund include offshore funds (including hedge funds) not approved by or registered with the Financial Supervisory Commission of the Executive Yuan. Since such funds are subject to a lower level of supervision and regulation, and they use alternative investment strategies, risk exposure is generally different than that of traditional funds."

In addition, when a SITE invests in offshore funds not approved by or registered with the FSC, it must incorporate criteria for the selection of such offshore funds, as well as risk monitoring and control measures, into its internal control systems. These criteria and measures should be approved by the SITE's board of directors.