

How to market hedge funds in India

Jan 21 2009 [Divaspati Singh and Kishore Joshi](#)



Divaspati Singh

The funds regime in India is at a nascent stage, therefore, India is not considered as a hedge fund jurisdiction. There is a separate regulatory regime for foreign hedge funds to invest in India as a foreign institutional investor; however, there is no such regulatory regime for hedge funds to be set up or marketed in India. This may be because of an absence of a domestic hedge fund regime. There is no specific set of laws or regulations that govern setting up or marketing hedge funds in India and the general principles of corporate law and exchange control laws are applicable as discussed below.

Permitted marketers

India does not have any regulatory regime for the marketing of offshore hedge funds in India; there are no provisions that govern the private placement in the securities of foreign funds in India. Due to the absence of full capital account convertibility, however, India has certain exchange control restrictions. Due to these, Indian residents are not permitted to invest in foreign securities except as according to the regulations that are framed under the Foreign Exchange Management Act, 1999 or as prescribed by the Reserve Bank of India through a specific or general permission.



Kishore Joshi

Currently, a hedge fund can explore the following options for marketing/advertising and offering its shares in India:

Marketing to Indian resident individuals

On February 4, 2004, the RBI introduced a liberalised remittance scheme (see circular no. 64) which permitted Indian resident individuals to invest up to \$25,000 per year for any purpose including investment in foreign securities. This ceiling has now been increased (see circular no. 9 of September 26, 2007), which provides for the liberalisation of up to \$200,000 per financial year for remittance outside India by Indian resident individuals for any purpose that includes investment in foreign securities.

Separately, there is another option for the acquisition of foreign securities by Indian resident individuals, which would be possible provided that the amount that Indian resident individuals paid for such foreign securities is paid out of a resident foreign currency account. An Indian resident individual can, under certain circumstances, maintain an RFC account, which is a foreign currency account, wherein he can receive his income in foreign currency from abroad. In addition to defraying of local expenses and making local

investments, the funds in the RFC account could also be used for investment abroad (including in shares of an offshore hedge fund) or for any payment of expenses abroad. The \$200,000 restriction on remittance is not applicable to an RFC account.

The RBI has prescribed that if an offshore fund's shares are marketed in India by appointing an Indian bank to market such shares to Indian resident individuals, the fund has to fulfil the conditions prescribed in circular no. 80 of March 18, 2004. Circular no. 80 provides for the requirement of seeking prior approval from the RBI for the schemes that the Indian and foreign banks in India market to residents for acting as agents for overseas mutual funds or any other foreign financial services company. An Indian bank must file an application with the RBI for seeking approval for the marketing of foreign securities. Based on the background of the transaction and terms of the offering, the RBI may grant approval subject to applicability of certain conditions that the Indian or foreign bank must comply with.

Marketing to Indian mutual funds

Offshore hedge funds can also market their securities to Indian mutual funds. Indian mutual funds can invest in aggregate up to \$7bn in foreign securities. It is pertinent to note that an Indian mutual fund can invest only up to 10 per cent of its net assets in foreign securities. A maximum of \$300m investment in foreign securities is permissible to each Indian mutual fund, however, irrespective of the size of the assets. A limited number of qualified mutual funds have also been allowed to invest cumulatively up to \$1bn in overseas exchange traded funds.

Marketing to Indian companies

An Indian listed company can invest in foreign companies listed on a recognised stock exchange up to 50 per cent of their net worth. The RBI regards these as portfolio investments and has given a general permission for such investments.

Permitted offerees

Accredited investors

The concept of an "accredited investor" or "sophisticated investor" is not prevalent under Indian securities laws or Indian corporate laws. Accordingly, any offering of shares to at least 50 persons (irrespective of their category) would constitute a public offering and the fund would be required to issue and register a prospectus for the same. Under Indian laws, there is no general availability of private placement exemption. If the offering is to less than 50 persons, however, no prospectus would be required to be issued. For constituting a public offering of the shares of a fund, the restriction is on the number of persons alone, and does not depend on the amount of money that is being invested or the status of the investor.

Restrictive legend

A legend should be affixed to each offering memorandum which is circulated in India that provides all the restrictions applicable under the foreign exchange regulations in India.

Limit on number of offerees

Apart from the Indian exchange control regulations, there are certain Indian company law requirements that the fund must comply with in certain circumstances. If the shares of a fund are offered to at least 50 persons in India, a prospectus would be required to be issued and the same would be required to be filed with the registrar of companies. As per section 2(36) of the Companies Act 1956, a "prospectus" means any document which is described or issued as a prospectus and includes any notice, circular, advertisement or other document that invites deposits from the public or offers from the public for the subscription or purchase of any shares in, or debentures of, a body corporate. Where a company allots or agrees to allot any shares of the company with a view to all or any of these shares being offered to the public, any document by which the offer for sale to the public is made shall be deemed to be a prospectus issued by the company.

Under section 605 of the Companies Act 1956, in India no person is allowed to issue, circulate or distribute any prospectus that offers for subscription of shares in or debentures of a company incorporated or to be incorporated outside India, unless before such circulation or distribution of the prospectus in India, a copy thereof, that the chairman and two managing directors of the company certifies in the prescribed manner, has been filed with the registrar of companies.

The prospectus may have to comply with elaborate disclosure requirements that are comparable to a public issue, which may be impractical and at times difficult to comply with. In the absence of any specific directions from the Securities and Exchange Board of India or the Department of Company Affairs, a hedge fund and its managers should ensure that the placement of shares of such fund should be done strictly on a private placement basis and limit general solicitation. The offer should be limited to less than 50 persons.

It should be kept in mind that the road show presentation materials and other marketing/advertising materials are provided on a one-to-one basis and the total number of persons to whom such material is provided are less than 50 to avoid prospectus requirements. Any such material should make appropriate disclosures that the shares are not being offered to the public and are only for private placement purposes and any distribution should be restricted to eligible investors. There may be a risk that an extensive selling exercise, such as road shows combined with the provision of promotional material, may be construed as a public offering and, therefore, would be subject to prospectus requirements under the Companies Act 1956.

• **Divaspati Singh** is an associate at Nishith Desai Associates. He is a part of the Corporate and Funds team. He has undertaken various transactions involving structuring, setting-up and documentation of domestic and overseas private equity funds, hedge funds, venture capital funds and real estate funds and he has also advised and assisted clients on FII registrations and issues relating to FII investments and has published articles on hedge funds and structures. **Kishore Joshi** is a senior associate. is a member of the Corporate and Securities Practice Group and Funds Practice Group. He focuses on various aspects of exchange control regulations including setting up of offices in India, outbound investments, etc. and also handles all the FII related matters. Tel: +91 22 6669 5000, www.nishithdesai.com

This article first appeared on Complanet on www.complanet.com on January 21 2008. For a free trial of Complanet's services, please contact client support on client.support@complanet.com or +44 (0) 870 042 6400.