



## New FDI policy bars warrant issue to FIIs

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**Mumbai** : The consolidated foreign direct investment (FDI) policy issued by the commerce ministry last week has virtually banned the issue of warrants and partly paid shares to FIIs. Though the government circular says it's a mere consolidation/ compilation and does not intend to change the existing legal framework, the circular clearly says that "any other type of instruments like warrants, partly paid shares etc are not considered as capital and cannot be issued to persons resident outside India".

Earlier, the FDI policy was silent on the issuance of convertible warrants and partly paid-up shares by Indian companies to foreign investors. It only contemplated issuances of shares and debentures. In the absence of legislative guidance, investors and issuers sought the approval of the FIPB for issuances of warrants and partly paid up shares, and the FIPB granted it on a discretionary and case-specific basis. "With the introduction of this note, there appears to be a complete bar against the issuance of warrants and partly paid up shares. This implies that the FIPB would not have the authority to consider or approve issuance of warrants, partly paid up shares or any other security that is not explicitly permitted under the policy," said corporate law firm Nishith Desai Associates.

According to market sources, a warrant issue gives considerable flexibility to the investor. "Warrants can get earn them money till conversion. These instruments can be converted at a convenient time. There was also misuse of warrant issue by some companies and investors. It was rampant in the early 2000," said an investment banker. In another major change, a foreign venture capital fund (FVCI) can now invest in a VCF (that is set up as a trust registered under the Indian Trust Act, 1882) only after obtaining prior government approval. Investment in a trust which is not registered with Sebi as a VCF is not permitted as per the new regime. "Earlier, a Sebi-registered foreign venture capital investor was allowed to invest in a domestic VCF registered under the Sebi (Venture Capital Fund) Regulations, 1996, under the automatic route — this is, without any approval being required. Accordingly, there was no distinction with respect to accepting foreign investment from an FVCI for a VCF, structured either as a company or as a trust. With this circular, the position seems to have changed," said a legal source.

He said these changes impede a commonly used 'unified' structure and severely restricts the structural alternatives available for such funds. "Another concern that may arise is on account of ambiguity as to whether in the case of a 'unified' structure that is already in place and in the absence of any grandfathering provision in the policy," he said.