

Corpsec Hotline

March 13, 2012

EXPANDED INVESTMENT HORIZON FOR FOREIGN VENTURE CAPITAL INVESTORS: RBI PROVIDES A MUCH NEEDED BREATHER!

The Reserve Bank of India ("RBI") vide circular¹ dated March 19, 2012 ("Circular") has allowed Securities and Exchange Board of India ("SEBI") registered foreign venture capital investors ("FVCIs") to invest in Eligible Securities² by way of private arrangement or purchase from a third party³. RBI has also clarified vide the Circular that FVCIs would be allowed to invest in securities on a recognized stock exchange subject to the provisions of the SEBI (FVCI) Regulations, 2000, as amended from time to time ("FVCI Regulations").

BACKGROUND

Until recently, on account of duality of regulators involving SEBI and the RBI, in respect of FVCIs which are licensed by both these authorities, there was an ambiguity on two counts for FVCIs: one, the ability of FVCIs to purchase existing shares from existing investors / shareholders under the FVCI route, as against fresh issuance of new shares by the Indian venture capital undertaking ("VCU") which was clearly permitted and second, whether FVCIs can make investments in listed securities which are permitted under the FVCI Regulations.

While there was no specific restriction under the FVCI Regulations in respect of purchase of existing shares from existing investors, based on certain informal guidance issued by RBI to certain custodian banks, they did not permit their FVCI clients to purchase secondary shares of a VCU by way of private arrangement with third parties. In fact, after much confusion on the issue, this view of the custodians was endorsed by the RBI in its Master Circular⁴ dated July 1, 2011 stating that FVCIs cannot acquire securities by way of a private arrangement with a third party. This specific restriction, combined with the sectoral restrictions on investments by FVCIs, again being imposed by the RBI, significantly curbed the investment flexibility available to FVCIs and the entire utility of this regime to a great extent.

Further, in respect of an FVCIs ability to invest in listed securities, it may be noted that the conditions with which the RBI approvals were granted to the FVCIs and based on the reading of Schedule 6 of the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000⁵ ("TISPRO"), there was no explicit permission available to the FVCIs to make investments in listed securities since investment by FVCI was only permitted in venture capital funds⁶ ("VCF") and VCUs⁷ which was defined to mean companies which are not listed on a recognized stock exchange. On the other hand, FVCI Regulations permitted FVCIs to invest 33.33% of their investible funds in, inter alia, (a) preferential allotment of equity shares of a listed company subject to lock-in period of one year; (b) subscription to initial public offer of a VCU whose shares are proposed to be listed; and (c) equity shares or equity linked instruments of a financially weak company or a sick industrial company⁸ whose shares are listed.

THE CIRCULAR

With the issuance of this Circular, FVCIs have now been allowed by RBI to invest in the Eligible Securities by way of private arrangement or purchase from a third party, subject to terms and conditions as stipulated in Schedule 6 of TISPRO as amended from time to time. Schedule 6 of TISPRO lays down the criterion in respect of purchase of eligible securities, opening and maintenance of bank accounts, valuation of investments etc. based on which the FVCIs can make investments in India.

The cloud of ambiguity pertaining to the FVCIs being allowed to invest in listed securities has also been cleared. It has been clarified by RBI vide this Circular that FVCIs are permitted to invest in securities on a recognized stock exchange subject to the provisions of the FVCI Regulations as well as the terms and conditions stipulated therein.

ANALYSIS

Clearly the Circular stipulates that henceforth FVCIs shall be permitted to undertake secondary purchase of shares in a VCU from existing shareholders. Further, RBI has also provided the necessary clarity in respect of investment by registered FVCIs in listed securities subject to FVCI Regulations. Having said that, one question that could arise out of the said Circular is, would FVCIs be allowed to invest in all instruments as permissible under the FVCI Regulations. It is too early to interpret this Circular to anything beyond what is obviously stated here, but if one could potentially look at this Circular as a move toward harmonizing the FVCI regime entirely with the FVCI Regulations and effectively giving SEBI a single point regulatory responsibility for this regime, which was how originally this regime was envisaged to operate, it could bring the FVCI regime on par with VCF Regulations in terms of choice of investment instruments.

While FVCIs have been granted specific permission by RBI to purchase Eligible Securities by way of private

Research Papers

Handbook on New Labour Codes

April 29, 2024

Compendium of Research Papers

April 11, 2024

Third-Party Funding for Dispute Resolution in India

April 02, 2024

Research Articles

Private Client Insights - Sustainable Success: How Family Constitutions can Shape Corporate Governance, Business Succession and Familial Legacy

January 25, 2024

Private Equity and M&A in India: What to Expect in 2024?

January 23, 2024

Emerging Legal Issues with use of Generative AI

October 27, 2023

Audio

Third-Party Funding: India & the World

April 27, 2024

IBC allows automatic release of ED attachments: Bombay HC reaffirms

April 15, 2024

The Midnight Clause

February 29, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Q&A 2024 Protocol to the Mauritius India Tax Treaty

April 22, 2024

Boost to India's Space Potential: India Liberalizes Foreign Direct

arrangement or purchase from a third party, based on recent interactions with the RBI, there seems to remain a restriction on the ability of the FVCI entity to sell the shares of a VCU to non-resident non-FVCI investors. This may significantly impact the exit opportunities available for FVCIs.

CONCLUSION

In the gloom set out by the recent Finance Budget (India Budget Insights 2012-13), this move by RBI seems to have come as a fresh breath for the foreign private equity investors. Further, in an environment that is throwing up interesting opportunities in the listed entities combined with more flexible takeover regulations now, with a higher limit for open offer trigger, the clarification on FVCI investment in listed securities is likely to be received with some excitement.

Needless to say, a big relief for FVCIs would come should the RBI decide to follow the footsteps of the Finance Minister and remove the sectoral limitations which are being imposed by them on FVCIs since 2008. The recent proposal in the Finance Budget is to extend the tax 'pass-through' status to VCFs for their income from investments in VCUs operating in all sectors by removing the sectoral limitations under current section 10(23FB) of the Income Tax Act, 1961. Likewise, a move to remove such sectoral restrictions imposed on FVCIs by the RBI, which have significantly eroded the benefits of FVCI regime, will bring much needed parity between the VCFs and the FVCI, sending out a strong positive message to the offshore investing community.

– Ajay Singh Solanki, Sahil Shah & Siddharth Shah
You can direct your queries or comments to the authors

¹ RBI/2011-12/452/A.P. (DIR Series) Circular No.93
² Equity, equity linked instruments, debt, debt instruments, debentures of venture capital undertaking or of a venture capital fund, units of schemes / funds set up by a venture capital fund.
³ http://articles.economictimes.indiatimes.com/2012-03-20/news/31214792_1_fvci-route-fvci-regulations-foreign-venture
⁴ RBI/2011-12/15/Master Circular No. 15/2011-12 dated July 1, 2011
⁵ 5 Notification No. FEMA 20 / 2000 -RB dated May 3, 2000
⁶ As per Regulation 2 (va), TISPRO venture capital fund means a fund established in the form of a trust, a company including a body corporate and registered under the Securities and Exchange Board of India (Venture Capital Fund) Regulations, 1996 which has a dedicated pool of capital raised in a manner specified under the said Regulations and which invests in venture capital undertakings in accordance with the said Regulations.
⁷ As per Regulation 2 (va), TISPRO (Indian) venture capital undertaking means a company incorporated in India whose shares are not listed on a recognized stock exchange in India and which is not engaged in an activity under the negative list specified by SEBI.
⁸ Defined under Explanation to Regulation 12(d)(ii)(d) of the FVCI Regulations.

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.