

Co-investments in overseas PE/VC funds may hit a wall

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By Ashley Coutinho

Co-investments made by investment advisors and individual resident investors into [private equity and venture capital funds](#) set up outside India may run into a wall under the current ODI regime.

Prior to the new guidelines issued earlier this month, many Indian investment advisors remitted up to \$250,000 to meet the co-investment obligation under the LRS route as investment in PE/VC funds was permitted.

Until now, these advisors would invest in the funds directly under the LRS route or through a special purpose vehicle structure that would be set up outside India. The SPV would then invest into the fund.

“Employees of these investment advisors in India could earlier co-invest in SPVs which in turn would invest into an offshore fund. This may no longer be possible given the restriction on investment into foreign unlisted, non-

operating entities,” said Parul Jain, head of fund formation at Nishith Desai Associates.

Under the new guidelines, the investment fund, where the co-investment amount needs to be invested, has to be regulated by the host country’s regulator for the financial services sector.

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“Most countries regulate fund managers and do not regulate the fund itself. If the [RBI](#)’s view is that investment should be permitted in funds managed by regulated fund managers, it would be necessary to provide this clarification to the authorised dealers so that they take a consistent position,” said Bhavin Shah, Partner & leader – Deals, PwC India.

For funds set up in Singapore, for instance, both the fund manager and the fund are regulated. In the US, it’s

the manager which is regulated but the fund is not. In Cayman, it is the fund which may be regulated.

“What do you really mean by registration or regulated? In the US, a form has to be filed with the SEC providing information about the fund; does that mean that the fund is regulated? Can you take that view?” said an industry official.

The new regulations could also impact Indian residents investing in funds set up outside India under the LRS route.

“It seems that as of today, any investment amount sent by individuals to funds which are not regulated by the host country regulator may be in contravention of the RBI’s guidelines. Attention from the RBI on this matter will help,” said Shah.

Jain feels that while the Overseas Investment Directions issued by the RBI to ADs permit investment by resident individuals into a foreign investment fund, the Overseas

Investment Rules notified by the government do not. So, further clarifications may be needed in this respect.

As per the master directions, investment may be made into the investment fund directly, provided the fund itself is registered or regulated outside India. The issue of being regulated may need to be seen on a case by case basis since all funds operating outside India may not necessarily be regulated, said Jain.

Further, the issue is compounded for individual resident investors who had committed to invest in overseas funds under the LRS route. “In the event that such investment is not permitted due to the fund not being regulated, this may result in the individual investors defaulting on their signed commitments to such overseas funds,” added Jain.

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