

## PE, VC funds form shadow panels amid rules delay

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Private equity (PE) and venture capital (VC) funds registered as alternative investment funds (AIFs) are forming shadow investment committees (IC) as formal appointments of foreign nationals in such panels have been barred, pending an opinion from the Reserve Bank of India (RBI) about the validity of such hiring, two people familiar with the development said.

In October 2020, the Securities and Exchange Board of India (Sebi), India's markets regulator, wrote to RBI seeking its view on whether having non-residents on the IC would make the AIF foreign-controlled. In the meantime, Sebi prohibited AIFs from hiring foreign nationals on their ICs. However, the central bank has yet to give its opinion on the matter, and the prohibition may extend until the opinion comes, the people said.

However, it is a common practice among AIFs, especially the funds that specialize in investing in the technology sector, to hire people with global exposure on their ICs. Due to the Sebi prohibition, these non-residents cannot be officially appointed to ICs.

Hence, the funds are instead hiring them in an advisory position, technically out of the ambit of IC rules. Instead of making an investment decision, these non-residents provide their opinion to the fund managers who take the final call on investment.

Emails sent to spokespeople for Sebi and RBI remained unanswered.

"For any investment approving investment committee, it has been close to three years since no AIF applications have been processed by Sebi if there is any external member who is not a resident Indian citizen," said Tejesh Chitlangi, senior partner, IC Universal Legal.

He added that the solution could be to permit external non-resident members on any decision-making investment committees whilst treating such AIFs as foreign-controlled, requiring them to follow FDI downstream investment norms. "A clarification on these lines by RBI, instead of a blanket prohibition, is desirable."

To be sure, there is no restriction on foreign nationals being on board these AIFs. There is also no prohibition on non-residents being an employee of the AIF.

According to Nandini Pathak, leader of investment funds practice at Nishith Desai Associates, Sebi is currently not reviewing any AIF application in which the IC has even a single member who is not an Indian resident citizen.

“This is too harsh a condition and impacts ‘ease of doing business in India’. Sebi deferred to RBI on this issue a couple of years ago, but no clarity has come from the regulators so far,” Pathak said. “IC members are chosen to add strategic value in the functioning and governance of the fund, which ultimately protects and benefits the fund investors. Often, IC members may be nominated by investors who, among other things, have specific sector expertise relevant to the fund.”

Investment committees are specifically formed in AIFs to provide guidance and expertise in niche sectors. However, they only provide recommendations to the fund manager regarding investments. The actual investment call is taken by the fund manager, who is normally an employee of the fund house.

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