

## Corpsec Hotline

April 20, 2004

### SEBI AMENDMENTS EASES 'VENTURING' INTO INDIA

With the Indian economy 'shining', the pace for reforms has accelerated. The Securities and Exchange Board of India ("SEBI") contributed to the 'feel good' factor and announced the much awaited amendments to the Venture Capital Funds ("VCF") Regulations, 1995 and Foreign Venture Capital Investors ("FVCI") Regulations, 2000. These amendments are expected to smoothen the flow of venture capital in the country and are likely to give significant momentum to venture capital activity in India. These amendments also give a clear indication that the government and the regulators are willing to go that extra mile in making the investment climate in India a lot more conducive. The main features of the proposed amendments viz. SEBI (VCF) (Amendment) Regulations, 2004 ("VCF Amendments") and the SEBI (FVCI) (Amendment) Regulations, 2004 ("FVCI Amendments"), are as follows:

#### Investments in Real Estate

VCFs are now permitted to invest in the real estate sector.

**Implications:** This amendment could potentially open up the path for structuring of Real Estate Investment Trusts by domestic VCFs. Though this amendment is also proposed in the FVCI Amendments, since FVCI are also governed by the Industrial Policy of the Government of India, which restrict investment in the real estate sector (other than in integrated townships), FVCIs would be permitted to invest directly only in integrated townships.

#### Investment in Non-Banking Financial Companies

VCFs and FVCIs have been permitted to invest in any non-banking financial services company except those registered with the Reserve Bank of India and categorized as equipment leasing or hire purchase companies.

#### Investment in Optionally Convertible Instruments

VCFs and FVCIs can now invest in instruments convertible into equity shares or share warrants, preference shares, debentures compulsorily or optionally convertible into equity.

**Implications:** Pre-amendment, the definition of 'equity linked instruments' only included instruments that was compulsorily convertible into equity shares. With the amendment to the VCF and the FVCI Regulations, VCFs and FVCIs would now be provided with greater flexibility in structuring the type of investment instrument that can be used by them on their downline investment.

#### Removal of lock-in post IPO

The restriction on VCFs and FVCIs investing up to a maximum of 25% of its investible funds in subscription to initial public offering and in debt or debt instruments has now been relaxed to 33.33%. Further, the lock-in period of one year on shares subscribed by way of an initial public offering has been removed.

**Implications:** This will afford greater flexibility to VCFs and FVCIs in structuring their investment portfolio. Further, the removal of lock-in on shares subscribed to in an IPO will offer VCFs and FVCIs greater liquidity as they will be able to sell off their shares immediately after the IPO (subject to any contrary provision in the investment agreements).

#### Investment in Listed Securities

Under the 33.33% ceiling as mentioned above, VCFs and FVCIs can now invest in:

- Preferential allotment of equity shares of a listed company, subject to a lock-in period of one year;
- The equity shares or equity-linked instruments of a financial weak company (as defined under the VCF and the FVCI Amendments) or a sick industrial company whose shares are listed;
- Special Purpose Vehicles which are created by a VCF or an FVCI for the purpose of facilitating or promoting investment in accordance with the VCF Amendments or the FVCI Amendments (as may be applicable).

#### Implications:

1. Investments in equity shares of a listed company was a much-awaited amendment considering the excellent Private Investment in Public Enterprise (PIPE) opportunities that existed in Indian listed companies. However, the amendments provide for investments in listed entities only by way of a preferential allotment and does not specifically provide for secondary transfers. Thus, it could mean that if shares are acquired by VCFs or FVCIs under the preferential allotment, and if they are required to make an open offer under the SEBI Takeover

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Code, the amendments leave the issue un-addressed as to whether VCFs and FVCIs will be able to make open offers to existing shareholders.

2. In addition to investments in listed securities by way of a preferential allotment, VCFs and FVCIs may purchase shares of listed companies which are financially weak or a sick in which case the requirement to do it through preferential allotment would not apply. This would facilitate setting up of Asset Reconstruction Funds or Turnaround Funds

3. The VCFs and FVCIs will also have flexibility in structuring their investment in operating companies through separate SPVs which will also offer them flexibility to partner with other players in a proposed investment. This could also potentially facilitate Management Buy Out situations.

### **Compliance with Investment Restrictions**

SEBI has clarified that the investment restrictions and conditions shall be required to be achieved by the VCF / FVCI by the end of its life cycle.

**Implications:** Prior to the amendment, it was always questionable as to at what stage would SEBI apply the investment restrictions and the uncertainty about how regulators would impose such restrictions. The clarification essentially provides comfort to the VCFs/FVCI that their compliance with the investment restrictions would be verified at the end of the life cycle of the fund they would not have to be worried about aligning their investment portfolio with the investment restrictions on an ongoing basis.

### **In-Specie Distribution of Assets by VCFs**

Subject to the conditions contained in the fund documents, and with the consent of at least 75% of the investors, VCFs are now permitted to make in-specie distribution of assets of the scheme / fund floated by the VCF, at any time during the life of the VCF.

**Implications:** It is now not mandatory for VCFs to liquidate their assets at the time of distribution. They can now distribute non-cash components such as shares of a company to its investors which will give them added flexibility in terms of distribution.

### **Removal of investment restriction for FVCIs**

The investment restriction which capped the investment by a FVCI in one venture capital undertaking to 25% of the funds committed for investments in India has been done away with.

**Implications:** This would give greater flexibility to FVCIs without imposing upon them an obligation to make multiple investments. Effectively, while FVCIs still need to indicate the investible funds for India, they can invest this entire corpus in a single investment.

You can direct your queries or comments to [Siddharth Shah](#) &/or [Bijal Ajinkya](#)

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