# *Update*

# New Gateways opened for FVCIs: A New Booster to Foreign Investment in India

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# Update

The Budget 2012-13 put breather for Venture Capital Funds (VCFs) but had no offerings for Foreign Venture Capital Investors (FVCIs). The investments made by FVCIs have been regulated by Reserve Bank of India (RBI) as well as Securities and Exchange Board of India (SEBI). However, RBI, in its recent Circular dated March 19, 2012[1] ("the Circular") has clarified and placed SEBI as a single point regulatory body regulating FVCIs.

Vide the Circular, RBI has decided to open new gateways for FVCIs to invest in Indian Venture Capital Undertakings (IVCUs) and VCFs, ultimately placing the IVCUs and VCFs in a better position to stockpile more funds. The additional routes that have been permitted are:

- Investment in the eligible securities (equity, equity linked instruments, debt, debt instruments, debentures of an IVCU or VCF, units of schemes / funds set up by a VCF) ***by way of private arrangement or purchase from a third party***

  However, the investment will remain subjected to the terms and conditions stipulated under Schedule 6[2] of Notification No. FEMA 20 / 2000 -RB dated May 3, 2000 as amended from time to time.

- ***Investment in securities listed on a recognized stock exchange*** subject to the provisions of the SEBI (FVCI) Regulations, 2000[3].

  Therefore, in addition to the primary capital market, the FVCIs will have access to the secondary capital market where these entities can acquire shares/units from existing shareholders or unitholders. The same has now been incorporated in the New FDI Policy[4] issued by the Department of Industrial Policy and Promotion. However, the investment will be subject to

[1] The RBI Circular is available at: http://rbidocs.rbi.org.in/rdocs/notification/PDFs/AP93I190312.pdf

[2] Terms and conditions relate to purchase of eligible securities, valuation of investments, opening and maintenance of bank accounts.

[3] The SEBI Regulations can be viewed at: http://www.sebi.gov.in/acts/fvcregu.pdf

[4] The new FDI Policy can be read at: http://dipp.nic.in/English/Policies/FDI_Circular_01_2012.pdf . Also see Note on the New FDI Policy-Mix of Relief and Burden of Additional compliances and limitations, by Soma Bagaria and Nidhi Ladha at the given link:
http://india-financing.com/Note_on_the_new_FDI_policy.pdf

the provisions of the SEBI (FVCI) Regulations, 2000, as amended from time to time, as well as the terms and conditions stipulated therein.

Previously, FVCIs were allowed to purchase equity / equity linked instruments / debt / debt instruments, debentures of a IVCU or of a VCF through ***Initial Public Offer or Private Placement*** or ***to purchase units of schemes/funds set up by a VCF.***

Further, the position was ambiguous with regard to secondary market options available with FVCIs. While SEBI did not impose restrictions on purchase of shares of VCUs from existing shareholders, RBI had views otherwise and vide Master Circular on Foreign Investment in India, dated 1st July, 2011[5] made it clear that FVCIs cannot acquire securities by way of private arrangement with third party**-*"A SEBI registered FVCI can only acquire securities by way of public offer or private placement by the issuer of such securities and not by way of private arrangement with a third party."[Section III (iii)]***

Another aspect- Foreign Exchange Management (Transfer or issue of security by a person resident outside India) (Amendment) Regulations, 2000[6] did not provide for explicit permission to FVCI to make investment through secondary markets and made mention of permitted investment in VCFs and VCUs, as in "*The registered FVCI permitted by Reserve Bank may purchase equity / equity linked instruments / debt / debt instruments, debentures of a IVCU or of a VCF through Initial Public Offer or Private Placement or in units of schemes/funds set up by a VCF*". So what is not permitted by default becomes restricted. Whereas SEBI regulations clearly provided for investment in listed securities with a capping of 33.33%, as evident from Regulation 11(c) of the SEBI (FVCI) Regulations -*" not more than 33.33% of the investible funds may be invested by way of:(a) subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed."*

## IMPLICATIONS AND ANALYSIS

The Circular can be received with welcome hands- it will help to remove the ambiguity arising due to duality of Regulations. The initiative has served an interesting investment opportunity before the off-shore investors in terms of flexibility and liquidity and better entry options. But, simultaneously the investors

[5] The Master Circular can be viewed at: http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/15MFI300611F.pdf

[6] The RBI Regulations can be viewed at: http://rbidocs.rbi.org.in/rdocs/notification/PDFs/18183.pdf

need enhanced exit options too, if the Regulators wish to impart better liquidity conditions to the foreign investment sector.

However, some question marks still remain there, *viz*:

- What is the scope of private arrangement with third parties-any limitations and all?

- The definition of Venture Capital Undertaking under the RBI Regulations still remains as a domestic company whose shares are not listed in any recognised stock exchange. This is well in contradiction to the permission given to FVCIs to invest in listed securities of VCUs.

Another thing that assumes significance here is the approval by SEBI to frame the Alternative Investment Funds Regulations, 2012 ("AIF Regulations") in its Board meeting dated 2nd April, 2012[7] on the basis of broad guidelines laid therein. The broad guidelines prescribe that SEBI (Venture Capital Funds) Regulations, 1996 ("VCF Regulations") will stand repealed on AIF Regulations coming into force. Existing VCFs shall continue to be regulated by the VCF Regulations till the existing fund or scheme managed by the fund is wound up and these VCFs shall not raise any fresh funds after notification of these Regulations except commitments already made by investors as on date of the notification. The guidelines are silent on the impact of AIF Regulations on FVCIs. However, the Concept Paper on Proposed Alternative Investment Funds Regulations[8] issued by SEBI on August 1, 2011 proposed to retain the FVCI Regulations and not subsume these in the AIF Regulations-though there was an added proposal to amend the FVCI Regulations so as to allow FVCIs to invest in different AIFs such as SME Fund, Social Venture Funds in addition to Domestic VCFs. Presently, FVCIs are allowed to invest 100% of their investible funds in SEBI Registered VCFs-lets see what's in store for the FVCIs in the AIF Regulations. It is certainly a wait and watch situation for the potential investors.

[7] See http://www.sebi.gov.in/sebiweb/home/detail/23431/yes/PR-SEBI-Board-Meeting

[8] The Consultation Paper can be seen at: http://www.sebi.gov.in/cms/sebi_data/commondocs/alternativeinvestment_p.pdf