

## **Regulating Privately-pooled Investment Vehicles in India**

The Securities and Exchange Board of India (“SEBI”) has on 21st May 2012 notified the SEBI (Alternative Investment Funds) Regulations, 2012 - (“Regulations”) which is a comprehensive regulatory framework for regulating private pools of capital or “Alternative Investment Funds” (“AIF”). The Regulations seeks to legalize and control all Investment Funds which had hitherto been outside the purview of the Indian legal regime. As per the Regulations, any fund established in India in the form of a trust, a company, a limited liability partnership or a body corporate which is a privately pooled investment vehicle which collects funds from investors (Indian or Foreign) for investing as per a defined investment policy for the benefit of investors would be an AIF. The Regulations specifically exclude family trusts, ESOPs (Employees Stock Option Scheme), employee gratuity trusts, fund managed by securitization companies, holding companies, Special Purpose Vehicles not managed by fund managers and pool of funds which are directly regulated by any other regulator in India.

### **Registration of AIF’s :**

All existing funds falling within the definition of AIF’s will now need to register with SEBI. SEBI has permitted existing unregistered funds to continue to operate up to a period of 6 months from commencement of the Regulations. In special cases SEBI reserves the right to extend the period of registration for the exiting funds up to a maximum of 12 months. On registration, the AIF’s can launch schemes subject to filing of an information/placement memorandum with the Board along with applicable fees. The units of an AIF Scheme may be listed on a stock exchange subject to minimum tradable lots of Rs 1 crore. However, AIF have been restricted from raising funds through the Stock Exchange mechanism. All AIFs whether operating as Private Equity Funds, Real Estate Funds, Hedge Funds etc would now be required to register with SEBI.

### **Impact on existing Venture Capital Funds (VCF’s)**

With the onset of the Regulations, the SEBI (Venture Capital Funds) Regulations 1996 (“VCF Regulations”) have been repealed. In consequence of which all VCFs will now need to re-register under the Regulations subject to approval of two-thirds of their investors in value. The existing VCF’s will however continue to be regulated by the VCF Regulations till the existing fund or scheme managed by the fund is wound up. Existing VCF’s are however not permitted to increase the targeted corpus of the fund or scheme as it stands on the date of the notification of the Regulations.

### **Scope of the Regulations :**

The Regulation categories all privately-pooled investment vehicles broadly in 3 categories namely:

#### **i. Category I AIF**

Category I consists of those AIF’s which invest in start-ups or early stage ventures, social ventures, SME’s, infrastructure or other sectors which the Government or regulators consider socially or economically desirable and includes VCF’s, SME Funds, Social Venture Funds, Infrastructure funds and such other AIF’s as may be specified. These funds would be close ended with a minimum tenure of 3 years and will not be able to engage in leverage.

#### **ii. Category II AIF**

Category II AIF’s are those AIF’s for which no specific incentives or concessions are given by the Government or Regulator and which can not undertake leverage other than to meet day to day operational requirements. It includes Private Equity funds, Debt Funds, Fund of Funds and such other funds that are not classified in Category I or III. These funds shall be close ended with a minimum tenure of 3 years and shall not engage in leverage.

### iii. Category III AIF

Category III AIF's are those which employ diverse or complex trading strategies and leverage including through investment in listed or unlisted derivatives. It includes hedge funds which trade with a view to make short term returns. These funds may be open ended or close ended. Category III funds shall be regulated through issuance of directions regarding areas such as operational standards, conduct of business rules, prudential requirements and restrictions on redemption, conflict of interest as may be specified by the Board.

#### Investment Conditions:

The Regulations additionally stipulate various investment conditions for each category namely:

- The AIF cannot accept from an investor an investment of value less than Rs 1 crore.
- The minimum corpus of a AIF Scheme must be Rs 20 Crores and the maximum number of investors in a fund or any scheme is capped at 1000 investors.
- The continuing interest of a manager or sponsor in Category I and II should be not less than 2.5% of the initial corpus or Rs 5 Crores whichever is lower and such interest should not be through waiver of management fees whereas for Category III the continuing interest shall be not less than 5% of the corpus or Rs 10 Crores whichever is lower.
- Category I and II AIF's are not be permitted to invest more than 25% of the investible funds in one Investee Company whereas Category III AIF's would be able to invest not more than 10% of the corpus in one Investee Company.
- AIF's cannot invest in associates except with the approval of 75% of Investors by value.

The Regulations brings with it more transparency for the investors and disclosure on the financials, risk management, fees, material liabilities, valuations, change in control etc which is a welcome move. However, the practical working, internal fee structures, additional restrictions on investments in SME funds, Infrastructure funds etc will exert undue pressures on the AIF's working and may hamper its long term objectives and financial goals. Additionally, as compared to the erstwhile VCF Regulations, which imposed a minimum contribution of Rs 5 Lakhs per investor, the present Regulations impose a minimum contribution of Rs 1 crore per investor thereby limiting participation in India's AIF scene to High Net worth individual, Corporates and institutional investors. In spite of the same, the Regulations are nonetheless a positive attempt to bring unregulated funds within the ambit of SEBI's supervision and thereby ensure systemic stability in the ever evolving Indian Fund industry.

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### **E-Voting mandatory for top 500 listed companies**

SEBI has made electronic voting mandatory for all listed companies in respect of those businesses which are to be transacted through postal ballot. SEBI has indicated that the same would be implemented in a phased manner. To begin with, it is mandated for top 500 listed companies at Bombay Stock Exchange and National Stock Exchange based on market capitalization. Listed companies may choose any one of the agency which is currently providing the e-voting platform.

### **SEBI limits Consent Orders for Defaulters**

SEBI has vide its recent circular dated 25<sup>th</sup> May, 2012 amended its 2007 circular which provides the framework for passing of consent orders and for considering requests for the composition of offences. As per the circular dated 25<sup>th</sup> May, 2012 SEBI shall not settle the following defaults list i.e.:

- Insider trading.
- Serious fraudulent and unfair trade practices causing substantial losses to investors and/or affects their rights, especially retail investors and small shareholders or have or may have market wide impact.
- Failure to make the open offer.
- Front-running.
- Defaults relating to manipulation of net asset value or other mutual funds defaults;
- Failure to redress investor grievances.
- Failure to make such disclosures under the ICDR and Debt Securities Regulations, which materially affect the right of the investors.
- Non-compliance of summons issued by SEBI.
- Non compliance of an order passed by the Adjudicating Officer (AO), Designated Member (DM) or Whole Time Member (WTM).
- Any other default by an applicant who continues to be non-compliant with any order passed by the AO or DM or WTM.

The High Powered Advisory Committee/Panel of WTMs however reserves rights based on the facts and circumstances of the case to settle any of the defaults listed above.

### **RBI Liberalizes Capital Account Transactions**

The Reserve Bank of India (“**RBI**”) has further liberalized Capital Account Transaction & has now permitted Indian Companies in manufacturing and infrastructure sector and having foreign exchange earnings to avail of External Commercial Borrowing (ECB) for repayment of outstanding Rupee loans towards capital expenditure and/or fresh Rupee capital expenditure under the approval route with an overall ceiling of USD 10 billion. Further, the existing limit for investment by Securities and Exchange Board of India (SEBI) registered foreign institutional investors (FIIs) in Government securities (G-Secs) has been enhanced by a further amount of USD 5 billion. This takes the overall limit for FII investment in G-Secs from USD 15 billion to USD 20 billion. The non-resident investor base for G-Secs has also been widened to include long term investors like Sovereign Wealth Funds, multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks to be registered with SEBI. The terms and conditions for the scheme for FII investment in infrastructure debt and the scheme for Non-Resident investment in Infrastructure Development Funds have been further rationalized in terms of lock-in period and residual maturity.

### **White Label ATMs (WLAs) now a reality in India**

In terms of the existing rules and regulations, only banks were permitted by Reserve Bank of India (“**RBI**”) to set up Automated Teller Machines (“**ATMs**”) as extended delivery channels. However the RBI vide its guidelines dated 20<sup>th</sup> June 2012 has now permitted Non-Bank Entities (“**NBEs**”) incorporated in India under the Companies Act, 1956 to set up, own and operate ATMs in India. NBE’s that intend setting up, owning and operating ATMs would be christened as “White Label ATM Operators” (WLAOs). They will provide banking services to the customers of the banks in India, based on the cards (debit/credit /prepaid) issued by the banks. NBEs would be permitted to set up WLAs in India, after obtaining authorization from the RBI under the Payment and Settlement Systems (PSS) Act 2007. The minimum net worth of the NBE is required to be Rs 100 crore as per the latest financial years audited balance sheet which has to be maintained at all times to start up the WLAs in India.

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