

Corpsec Hotline

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INDIAN VENTURE CAPITAL FUNDS CAN INVEST ABROAD

The Reserve Bank of India ("RBI") has on April 30, 2007, issued the much-awaited circular ("Circular") which permits domestic venture capital funds ("VCFs") registered with the Securities and Exchange Board of India ("SEBI") to invest abroad. Based on this Circular, VCFs are now permitted to invest in equity and equity-linked instruments of off-shore venture capital undertakings, subject to an overall limit of USD 500 million. Before investing abroad, VCFs will be required to obtain SEBI's approval. While granting its approval, SEBI may specify terms and conditions for such investments. The Circular also provides that SEBI will make allocations of limits (from the prescribed overall limit of USD 500 million) to individual VCFs seeking approval to make offshore investments.

The Circular has been issued pursuant to the SEBI Venture Capital Funds (Amendment) Regulations 2006 ("2006 Amendment"), that enabled SEBI registered VCFs to invest in securities of foreign companies. Further, the Circular also permits VCFs to invest in offshore venture capital funds provided they obtain a prior approval from SEBI for the same. Once the SEBI approval has been obtained, no separate RBI permission is required.

While the 2006 Amendment allows VCFs to invest in "foreign companies", the Circular refers to offshore venture capital undertakings and offshore venture capital funds. Foreign companies is defined in section 591 of the Indian Companies Act, 1956 to mean companies which are incorporated outside India and have a place of business in India. The SEBI VCF Regulations, 2006 defines a venture capital undertaking to *inter alia* mean a company whose shares are not listed on a recognized stock exchange in India.

Necessary amendments to Foreign Exchange Management (Transfer or Issue of Any Foreign Security), Regulations, 2004 shall be issued by the RBI separately.

Analysis

Neither the Circular nor the SEBI VCF Regulations specifically define 'off-shore venture capital undertakings' or 'offshore venture capital funds' and therefore it remains to be seen if SEBI will introduce a new definition in this respect. On an initial reading of the definition of foreign companies referred to under the 2006 Amendment, there appears some anomaly in so far as the foreign company is defined to mean companies incorporated outside India which have a place of business in India, whereas it appears, that the intention of the Circular is to permit Indian VCFs to invest in any unlisted company abroad. It is also unclear at this stage whether a VCF would require investment specific approval or whether it could obtain a one-time approval from SEBI for all future overseas investments.

Implications

This development introduces a whole new investment horizon to the Indian venture capitalists. Hopefully, it should fall in line with Indian venture capital funds' current strategies and provide them with better structuring opportunities. The move will also allow Indian companies to partner with VCFs to target investments in or acquisitions of foreign companies.

Certain concerns have been expressed as to whether the USD 500 million over-all limit as prescribed by the RBI is adequate, especially considering that the overseas limits for mutual funds itself have been increased to over USD 4 billion.

Sources:

- Overseas Investment by Venture Capital Funds (VCFs), Circular no. RBI/2006-2007/370 [A. P. (DIR Series) Circular No. 49
- Domestic VCFs can invest in unlisted overseas firms Economic Times Mumbai; May 02, 2007

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