



INTRODUCTION

On 1st August 2011, Securities and Exchange Board of India (SEBI) issued a concept paper for the introduction of SEBI (Alternative Investment Funds) Regulations, 2011. This Concept paper has been put for public comments by 30th August 2011. These Regulations provide a framework for registration and regulation of investment funds which raise capital from a number of institutional and High Net worth Investors (HNIs).

SEBI (Venture Capital Funds) Regulations, 1996, which presently governs the Venture Capital Funds in India, will be repealed with the introduction of AIF Regulations. The AIF Regulations will only impact domestic funds and shall not impact offshore funds investing in India under the Foreign Direct Investment Policy.

In this paper we have captured the salient features of the proposed AIF Regulations alongwith our views.

DEFINING ALTERNATIVE INVESTMENT FUNDS (AIF)

AIFs means pooling or raising of private capital from institutional or High Net Worth Investors (HNI) with a view to investing it in accordance with a defined investment policy for benefit of those investors and includes private pool of capital such as

- Private Equity Fund
- Venture Capital Fund
- Private Investment in Public Equity (PIPE) Fund
- Debt Fund
- Infrastructure Fund
- Real Estate Fund
- Social Venture Fund
- Small and Medium Enterprises (SMEs) Fund
- Strategy Fund

PROCEDURE FOR REGISTRATION OF AIFS

All AIFs will compulsorily be required to obtain a registration certificate from SEBI. The funds already registered under the existing Venture Capital Fund Regulation would continue to be regulated by the said regulations till the existing fund or scheme is wound-up. Registration from SEBI under the AIF Regulations will be required for each scheme launched by the fund. This means that any fund will not be allowed to launch additional schemes under the same registration.



Structure of AIF & Main Eligibility Criteria

AIF can be set up as Company, trust or body corporate including LLP (Limited Liability Partnership)

SEBI shall consider the following points in granting registration to an AIF:

- a) Experience of the sponsor or fund manager or asset management company of AIF in managing private pools of capital
- b) Track record, professional competence, financial soundness, experience, general reputation of fairness, etc of the sponsor or fund manager of AIF

Consideration of application

The SEBI, while considering application for registration of an AIF, will take into account all matters relating to investment objective of the fund, the target investors, size of the fund, investment style or strategy, professional qualification of the managers, necessary

INVESTMENT CONDITIONS AND RESTRICTIONS

Investment strategy

The AIF shall state investment strategy, investment purpose and business model in its information memorandum to the investors.

Any alteration to the fund strategy can be made with the consent of atleast 75% of unit holders. The AIF will be required to state its investment strategy, investment purpose and business model in an information memorandum to the investors.

Main Conditions

- a) The minimum size of the AIF has to be INR 20 Crores (INR200 million)
- b) Fund size has to be specified at the time of launch of the fund. However, it can be revised upward up to 25% after giving suitable reasons to the SEBI
- c) Minimum investment amount should be 0.1% of the fund size subject to a minimum of INR 1 Crore (INR10 million)
- d) The Sponsor / Designated Partner / Director of the fund should contribute from their own account an amount of investment equal to at least 5% of the fund which investment shall be locked-in till the redemption by all investors in the fund. This contribution cannot be through the waiver of management fees and has to be invested in the AIF
- e) The Sponsor / Designated Partner / Directors shall disclose its investment in the fund to the investors
- f) AIF can solicit investment by investors only through private placement by issuance of information memorandum



Term of the Fund

- a) All AIFs are required to be close ended and the duration of fund shall be determined at the time of registration
- b) The tenure of the fund shall be minimum for a period of 5 years
- c) Extension of the tenure of the fund may be permitted upto 2 years only at a time and to be approved by 75% of the beneficiaries. If the consent for extension is not obtained, the fund has to be liquidated within one year following the expiry of the fund term
- d) If any of the investments remains un-liquidated at the end of tenure of the AIF, the Sponsor / Manager / Director / Designated Partner shall be liable to take up such investments

General Investment Conditions & Restrictions

- a) The AIF can invest only in instruments specified by SEBI for each type of fund
- b) AIF cannot invest more than 25% of the fund corpus in a single investee company
- c) AIF are not permitted to invest in (i) Non Banking Financial Companies (excluding Infrastructure Finance Company, Asset Finance Company, Core Investment Company or companies engaged in microfinance activity in case AIF is not a Strategy Fund), (ii) Gold Financing (excluding gold financing for jewellery) (iii) Activities not permitted and under Industrial Policy of the Government of India

MAIN INVESTMENT CONDITIONS SPECIFIED FOR EACH CATEGORY OF AIF

1. Venture Capital Fund

- a) The objective of a Venture Capital Fund (VCF) shall be to promote new ventures using new technology or with innovative business ideas at early stage or start up stage primarily through acquisition of equity seed capital or minority stake.
- b) The total investment in the venture capital fund cannot be more than INR 250 Crores (INR 2.5 billion)
- c) Venture capital fund not permitted to invest in any company that is promoted, directly or indirectly by any of the top 500 listed companies by market capitalization or by their promoters
- d) Required to invest at least 66.66% of its corpus in unlisted equity shares of the investee company
- e) Permitted to invest upto 33.33% of its corpus: (i) in the unlisted debt or debt instruments of the investee company where equity investment has been made (ii) Preferential allotment of equity shares of a listed company subject to lock-in-period of one year (iii) The equity shares or equity linked instruments of financially weak company or a sick industrial company
- f) The fund cannot invest in warrants of the investee company



2. PIPE Fund

- a) PIPE fund shall invest in shares of small sized listed companies which are not part of any market indices in exchanges having nationwide terminals
- b) Required to invest at least 66.66% of its corpus in equity shares of investee company
- c) Permitted to invest upto 33.33% of the corpus in debt or debt instruments of such companies where equity investment has been made
- d) Notwithstanding anything contained in SEBI (Prohibition of Insider Trading) Regulations, 1992, a PIPE fund may acquire securities of investee company and may be given access to non public information subject to prescribed conditions which, inter-alia, includes that PIPE funds shall be prohibited from selling or dealing in securities of investee companies for a period five years.

3. Private Equity Fund

- a) A Private Equity Fund may invest in unlisted equity, equity linked instruments of companies which require funding to develop and grow with the primary focus on matching medium to long term capital of investee companies
- b) Required to invest at least 50% of the corpus in equity shares or equity linked instruments of an unlisted company requiring medium to long term capital to develop and grow
- c) Not more than 50% of its corpus to be invested in the equity or equity linked instruments of a company which is proposed to be listed
- d) Not more than 50% of its corpus to be invested in unlisted debt of a company where the fund has already made equity investment

4. Debt Fund

- a) Debt Fund is required to invest at least 60% of the corpus in debt or debt instruments of unlisted companies and not more than 25% of which may be invested in convertible debt, with minimum maturity of 5 years
- b) Permitted to invest upto 40% in
 - (i) securitized debt instruments
 - (ii) debt securities of listed company
 - (iii) equity shares of unlisted company where the fund has invested in unlisted debt instruments
- c) Fund to have a system of credit assessment irrespective of whether or not the securities are rated



5. Infrastructure Fund

- a) An Infrastructure Fund shall invest at least 66.67% of its corpus in the equity or equity linked instruments of infrastructure companies or SPVs of infrastructure projects as defined by Central Government or Planning Commission.
- b) Permitted to invest upto 33.33% of its corpus in debt instruments of investee company where it has made equity investment or in securitized debt instruments of an infrastructure company or special purpose vehicles of infrastructure project

6. SME Fund

- a) The SME fund can invest primarily in the unlisted equity or equity linked instruments of SMEs in manufacturing, services sector as also businesses providing infrastructure or other support to SMEs as defined by the Ministry of Small and Medium Enterprises
- b) Permitted to also invest in equity or equity linked instruments of SME companies which are listed or proposed to be listed in SME exchange or SME segment of a regional stock exchange
- c) Permitted to enter into an agreement with merchant banker to subscribe to the unsubscribed portion of a public issue or to receive or deliver securities in the process of market making

7. Real Estate Fund

- a) Real Estate Fund shall invest at least 75% of its corpus in real estate projects or fully built properties or in special purpose vehicles engaged in real estate projects
- b) Permitted to invest upto 25% of corpus in allied sectors of real estate
- c) Required to invest at least 66.67% of its corpus in equity or equity linked instruments, and permitted to invest upto 33.33% of its corpus in debt or debt instruments of real estate projects or special purpose vehicles engaged in real estate projects

8. Social Venture Fund

- a) The Social Venture fund could be targeted to investors who are willing to accept muted returns, say 10% to 12%
- b) The fund is required to invest in social enterprises such as MFIs which satisfy social performance norms laid down by the fund

9. Strategy Fund

- a) The Strategy fund may specify any strategy in any class of financial instruments
- b) Permitted to invest in derivatives, and complex structural products subject to requirement of suitability and disclosure to investors



- c) Permitted to leverage or float long or short strategy fund subject to consent from the investors in the fund, subject to a maximum leverage as may be specified by SEBI
- d) The fund which employs leverage will be required to disclose information regarding the overall level of leverage employed, the leverage arising from borrowing of cash or securities and the leverage arising from position held in derivatives, the reuse of assets and the main source of leverage in the fund

CONCESSIONS/ EXEMPTIONS FOR AIF

1. Due diligence done by funds prior to investing in listed companies would not attract provisions of SEBI Insider Trading Regulations.
2. AIFs such as PIPE funds or SME funds or VCFs would be considered as QIBs for the purpose of QIPs under the ICDR Regulations
3. Investments in NBFCs which are Core Investment Companies, Asset Finance Companies, Infrastructure Finance Companies or companies engaged in Micro Finance activities would be permitted for all types of AIFs (other than strategy funds).
4. The requirement of lock-in period of one year for pre-IPO investments would not be applicable in respect of investments made by PE Funds, SVF and SME Funds on the same lines as for VCFs.

OTHER HIGHLIGHTS

Prior approval from SEBI has to be taken by the AIF, if there is change of control of Sponsor or Fund Manager. The Sponsor or Manager of AIF has to appoint a custodian for safekeeping of securities of the fund, if the AUM (assets under management) are over INR500 Crores (INR5 billion)

AIF regulations also provides for a) Avoidance of conflicts of interest between the sponsor/manager; b) Transparency and disclosure of information to investors; c) Maintenance of records ; d) Redressal of investors complaints ; e) Dispute resolution

INDIA JURIS VIEW

AIF Regulations is a step which will further script the growth of the venture capital and private equity industry. The AIF Regulations will bring clarity on the regulation of private pools of capital raised domestically for deployment by various types of investment funds. Fine tuning is required with respect to certain disparity in investment conditions / restrictions in various categories of investment funds as prescribed under AIF regulations

Disclaimer

This newsletter is compiled and prepared by India Juris for information purposes only for the readers. Any material of this newsletter should not be deemed as legal advice by anyone. India Juris neither guarantee the correctness of the information published nor takes any responsibility whatsoever it may be.