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SEBI eases norms for start-up funding, increases investment avenues for FPIs**GAURAV N. PINGLE**

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SEBI, in its Board Meeting held on November 23, 2016¹, took some significant decisions which will have an impact on the corporates, foreign investors, compliance officers, and Indian investors at large. The 3 decisions taken by the SEBI Board are: (i) Proposal to amend SEBI (Alternative Investment Funds) Regulations, 2012 regarding Angel Funds, (ii) Proposal to amend SEBI (Foreign Portfolio Investors) Regulations, 2014 to permit FPIs to invest in unlisted Non-Convertible debentures and securitised debt instruments, (iii) Corporate Governance issues in Compensation Agreements. This article is a summary of the key decisions taken by the SEBI Board and its impact on the concerned market intermediary or market.

Easy norms for start-up funding:

Summary of Decision: In order to further develop the alternative investment industry and the start-up ecosystem in India, SEBI, in March 2015, constituted 'Alternative Investment Policy Advisory Committee' ('AIPAC') under the chairmanship of Shri. N.R. Narayana Murthy. AIPAC had submitted its report to SEBI with various recommendations including certain recommendations relating to 'Angel Funds'. Based on such recommendations in the Report and public comments thereon, SEBI Board has approved following amendments to SEBI (Alternative Investment Funds) Regulations, 2012 with respect to 'Angel Funds':

1. Increase in the number of angel investors in a scheme from 49 to 200,
2. Aligning the definition of 'start-up' for Angel Funds investments with the definition of DIPP in its Start-Up Policy. Due to the proposed amendment, Angel Funds will be allowed to invest in start-ups incorporated within 5 years, which was earlier 3 years,
3. Reduction in the requirements of minimum investment amount by an Angel Fund in any venture capital undertaking from Rs. 50 lacs to Rs. 25 lacs,
4. Reduction in the lock-in requirements of investment made by Angel Funds in venture capital undertaking from 3-years to 1-year,
5. Angel Funds are allowed to invest in overseas venture capital undertakings upto 25% of their investible corpus in line with other AIFs.

Analysis of the Decision: SEBI Board's decision of increasing the number of angel investors in a scheme from 49 to 200 is definitely a welcome move. This will help the start-ups in getting more funds from more investors and at the same time, start-ups will get more 'advisors' and 'mentors' for their project or product. The SEBI Board's proposal of aligning the definition of 'start-up' with DIPP's Start-Up Policy is also a noteworthy, as the start-ups can take necessary benefits on both – Regulations and Start-Up Policy. An

entity shall be considered as 'Start-up' (under DIPP Notification F. No. 5(91)/2015-BE. I dated February 17, 2016), where: (a) Up to 5 years from the date of its incorporation/registration, b) If its turnover for any of the financial years has not exceeded Rupees 25 crore, and c) It is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property. Pursuant to the alignment of the definition of start-up with DIPP notification, the Angel Funds will be allowed to invest in start-ups incorporated within 5 years (Earlier 3 years). Therefore, by the angel investor gets more time to invest in start-ups, which will help them in understanding the business model, business cycles and temperament of the promoters. SEBI Board has halved the minimum investment amount by an Angel Fund in any venture capital undertaking from Rs. 50 lacs to Rs. 25 lacs and reduced the lock-in requirements of investment made by Angel Funds in venture capital undertaking from 3-years to 1-year. The proposal of reducing the minimum investment amount by an Angel Fund and reduction in lock-in requirement will make the capital easily accessible and at the same time, it will increase the liquidity in the market. Such proposal will also invite more investors joining the league of 'angel investing' while getting to invest at lower ticket. The SEBI Board has sanctioned another proposal of allowing Angel Funds to invest in overseas venture capital undertakings up to 25% of their investible corpus in line with other AIFs.

All these decisions of SEBI Board have taken place as start-up funding and start-up listing had not taken the desired momentum. These proposed amendments have liberalised the extant provisions of the Regulations relating to Alternative Investment Funds, which is supposed to have a positive impact on the start-up funding and start-up listing. In order to give an effect to the said proposals, SEBI is required to amend respective clauses relating to 'Angel Funds' under SEBI (Alternative Investment Funds) Regulations, 2012 regarding Angel Funds. Currently, 266 AIFs are registered with SEBI, of which, 84 are registered under Category I, including four Angel Funds².

Permits FPIs to invest in unlisted NCDs and securitised debt instruments

Summary of Decision: Pursuant to the extant provisions of SEBI (Foreign Portfolio Investor) Regulations, 2014, investment in unlisted debt securities is permitted only in case of companies in the infrastructure sector. Pursuant to the extant provisions, SEBI does not permit the investment by FPIs in securitised debt instruments. SEBI, in its Board meeting, approved the proposal to allow FPIs to invest in following instruments:

1. Unlisted corporate debt securities in the form of non-convertible debentures/bonds issued by an Indian public or private company subject to the guidelines issued by MCA from time to time. Such investments shall be subject to minimum residual maturity of 3 years and end use-restriction on investment in real estate business, capital market and purchase of land. SEBI Board clarified that the expression 'real estate business' shall have the same meaning as assigned to it in FEMA Regulations;
2. Securitised debt instruments, which includes: (i) Any certificate or instrument issued by a Special Purpose Vehicle ('SPV') set-up for securitisation of asset(s) with banks, FIs or NBFCs as originators; and/or (ii) Any certificate or instrument issued and listed in terms of the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.

Analysis of the Decision: With an objective to enhance the investor base in certain securities (like: unlisted corporate debt securities, securitised debt instruments issued by SPV set-up for securitisation of asset(s) with banks, FIs or NBFCs), SEBI Board resolved to liberalise the investment avenues for FPIs. Presently, FPIs can invest only in unlisted debt securities of the companies engaged in infrastructure sector only. However, pursuant to the SEBI Board's approved proposal, FPIs are permitted to invest in non-convertible debentures/bonds issued by public company or private company. SEBI Board has placed a restriction on the end use-restriction on such FPI investment i.e. real estate business, capital market and purchase of land. SEBI Board's move of expanding the list of investment avenues for FPIs is definitely a welcome move, however the sectors (with reference to the end-use restriction) in which the investment is permitted are very few. It is also noteworthy that these sectors require high investment to generate high

returns over a period of time. The proposed decision, will increase the number of investors and amount of investment (per investor) in the capital market, which will further provide liquidity in the market.

SEBI Board has placed maximum threshold for investment by FPIs in the unlisted corporate debt securities and securitised debt instruments, i.e. upto INR 35,000 Crore within the extant investment limits prescribed for corporate bond from time to time (which currently is INR 2,44,323 Crore). Though the SEBI Board has approved the proposal, the same shall be effective by amendment to the SEBI (FPI) Regulations, 2014.

Corporate Governance Issues in Compensation Agreements:

Summary of Decision: The Board, in its meeting held on September 23, 2016, had deliberated the concerns related to private equity funds entering into compensation agreements to incentivize promoters, directors and Key Managerial Personnel ('KMP') of listed investee companies which could potentially lead to unfair practices. SEBI Board had on September 23, 2016 approved the proposal for initiating public consultation process, wherein the Consultation Paper was floated for public comments. Based on the comments received on the Consultative Paper, SEBI Board approved the proposal to amend Listing Regulations to enforce disclosures and shareholder approval for all such agreements (including existing agreements that extend beyond the date of the amendment).

Pursuant to the SEBI Board's decision, the revised norms for such disclosures and shareholder approvals are as under:

1. Only with the prior approval of the Board of Directors of the company and the public shareholders, the employee (including KMP), director or promoter of a listed entity shall enter into any agreement for himself or on behalf of any other person, with any shareholder or any other third party with regard to compensation or profit sharing,
2. Agreements entered into in the past (including those which may not be currently valid), i.e. during the past 3 years from the date of notification shall be informed to the stock exchanges for public dissemination,
3. Existing agreements entered into prior to the date of Notification and which may continue to be valid beyond such date shall be informed to the stock exchanges and the approval shall be obtained from public shareholders by way of an ordinary resolution in the forthcoming general meeting. The term 'public' shall carry the same meaning as defined under Rule 2 of Securities Contracts (Regulation) Rules, 1957,
4. Interested persons involved in the transactions shall abstain from voting on the said resolution.

Analysis of the Decision: Pursuant to the SEBI Board's approval to the proposal, listed entities would be required to take the prior approval of the Board of Directors and shareholders, where the employee (including KMP), director or promoter proposes to enter into any agreement, with any shareholder or any other third party with regard to compensation or profit sharing. This decision has a very wide implication and impact on the listed companies where Private Equities or Venture capital investors have invested. These agreements would be usually termed as 'Compensation Sharing Agreements' or 'Revenue Sharing Agreements' or 'Profit Sharing Agreements'. However, it is noteworthy that the approval of the Board of Directors of the company and shareholders would be required, even though the company would not be 'signing party' to the contract or revenue sharing agreement. For the said arrangement, the 'listed company' may be a 'consenting party'. In spite of this arrangement, requisite approvals would be required.

This proposal has been sanctioned by the SEBI Board with an objective to address the Corporate Governance issues in compensation agreements. The purpose was to ensure that Directors and KMPs enter into compensation agreements with select class of shareholders / investors after making requisite disclosures of the agreement and after taking requisite approval of the shareholders. Considering the approval process, voting pattern and requisite disclosures, it can be said that henceforth such agreements between company directors/KMP with the investors would become a rare case.

SEBI Board has approved the agenda which includes taking of approvals for the existing agreements entered into by the company. SEBI Board proposes following actions or compliance for existing compensation or profit sharing agreements:

1. Intimation to the stock exchanges for public dissemination about the agreements entered into during past 3 years,
2. Obtaining 'public shareholders' approval by way of an ordinary resolution in forthcoming general meeting for the existing agreements (i.e. entered into prior to the date of Notification).

For the purpose of shareholder's sanction, the 'interested persons' involved in the transactions will be abstained from voting on the said resolution. The introduction of shareholders' approval and prohibition by the 'interested person's to vote on the resolution is in line with the provisions of 'Related Party Transactions' under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Conclusion

The three decisions taken by the SEBI Board (as discussed above) will have a positive impact on the start-ups funding, equity markets and corporate governance principles. 'Corporate Governance issues in Compensation Agreement' has been the 'most discussed' issue in the recent times. Pursuant to the sanctioned proposal, the existing compensation agreements are within the purview of the stock exchange intimation and the proposed compensation agreements will require board approval and shareholders' approval. Considering the impact of demonetisation, SEBI may soon allow investments in Mutual Funds through digital wallets. Based on the media reports, such proposal would be considered by SEBI in its next board meeting.

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1. Press Release [PR No. 161/2016], dated November 23, 2016.

2. **Source:** <http://indianexpress.com/article/business/economy/sebi-board-meeting-start-up-funding-fpis-corporate-bonds-4392197>.