CONSULTATIVE PAPER ON AMENDMENTS TO FVCI REGULATIONS FOR PUBLIC COMMENTS

1. BACKGROUND

a. SEBI registers Foreign Venture Capital Investors (FVCIs) and regulates investments by FVCIs in India under SEBI (Foreign Venture Capital Investors) Regulations, 2000 ("FVCI Regulations"). FVCIs are investors incorporated and established outside India investing primarily in venture capital undertakings in India either directly or through venture capital fund(s)/alternative investment funds.

b. RBI through Schedule 6 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, also regulates the flow of money through FVCI route. Infrastructure is one of the sectors in which RBI has permitted investment under the FVCI route.

c. As on September 30, 2014, there are 197 FVCIs registered with SEBI with a cumulative net investment of Rs. 42,776 crore[1].

d. Further, FVCI investment in infrastructure sector as on September 30, 2014 amounted to more than Rs. 20,000 crore i.e. more than half of the total cumulative net investment by FVCIs in India. Major investment by FVCIs in the infrastructure sector is in power, telecom, roads, bridges, urban infrastructure, etc.

2. BACKGROUND ON CORE INVESTMENT COMPANIES (CICs)

a. The Reserve Bank of India is entrusted with the responsibility of regulating and supervising the Non-Banking Financial Companies by virtue of powers vested in Chapter III B of the Reserve Bank of India Act, 1934.

b. As on date, RBI classifies various NBFCs as under:

   i. Asset Finance Company (AFC)
   ii. Investment Company (IC)
   iii. Loan Company (LC)
   iv. Infrastructure Finance Company (IFC) (Introduced in Feb 2010)

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[1] As per latest quarterly data received by SEBI from FVCIs

v. Systemically Important Core Investment Company (CIC-ND-SI) (Introduced in August 2010)
vi. Infrastructure Debt Fund (IDF-NBFC) (Introduced in November 2011)
vii. Micro Finance Institution (NBFC-MFI) (Introduced in December 2011)
viii. Factors (NBFC-Factors) (introduced in July 2012)

c. As seen above, over last few years, RBI has carved out some specialized NBFCs like Core Investment Companies (CICs), NBFC- Infrastructure Finance Companies (IFCs), Infrastructure Debt Fund- NBFCs, NBFC-MFIs and NBFC-Factors being the most recent one.

d. Of the various types of NBFCs, the matter under discussion pertains to Core Investment Companies (CICs).

e. As per RBI[2]:

i. Core Investment Companies or CICs are companies which have their assets predominantly as investments in shares for holding stake in group companies but not for trading, and also do not carry on any other financial activity.

ii. A CIC-ND-SI is a Non-Banking Financial Company carrying on the business of acquisition of shares and securities which satisfies the following conditions:-

(a) it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;

(b) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;

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[2] **DNBS (PD) CC.No. 197/03.10.001/2010-11 dated August 12, 2010**
DNBS.(PD) 220/CGM(US)-2011 dated January 5, 2011
http://www.rbi.org.in/commonman/english/scripts/FAQs.aspx?Id=836

(c) it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;

(d) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.

(e) Its asset size is Rs 100 crore or above and

(f) It accepts public funds

iii. Existing CICs which were exempted from registration in the past and have an asset size of less than Rs 100 crore are exempted from registration from RBI in terms of section 45NC of the RBI Act 1934, as stated in RBI's Notification No. DNBS.(PD) 220/CGM(US)-2011 dated January 5, 2011.

iv. From the above, it is understood that while CICs are classified as NBFCs, they are essentially holding companies and do not engage in financing activity similar to other NBFCs. CICs, as per their definition, hold majority of their assets as investments in group companies and do not engage in financing activity other than that of investments/guarantees/loans mainly relating to its group companies.

v. In the infrastructure sector, due to various covenants under concession agreements and current format of public-private partnerships (PPPs), separate legal entities in the nature of Special Purpose Vehicles are usually formed to undertake projects. Therefore, it is observed that holding company model is suitable for the infrastructure sector and several major companies in the infrastructure sector are classified as CICs.

vi. RBI also, in order to strengthen the flow of resources into the infrastructure sector, vide its A.P. (DIR Series) Circular No. 78 dated December 3, 2013 allowed CICs to raise external commercial borrowing (ECB) for project use in special purpose vehicles.

3. PROPOSAL

a. Currently, SEBI (Foreign Venture Capital Investors) Regulations, 2000 do not permit FVCIs to invest in Non-Banking Financial Services *(with certain exceptions)*. Therefore, FVCIs are not permitted to invest in CICs under the FVCI Regulations since CICs are classified as NBFCs by RBI.

b. It is observed that the companies investing in infrastructure sector classified as CICs are not able to attract funds from FVCIs due to the aforesaid restriction under the FVCI Regulations.

c. Infrastructure is the backbone for the development of the country. According to the 12th Five Year Plan, India requires an investment in Infrastructure sector of around Rs. 65 lakh crores over the duration of 2012-2017. A significant boost is required to the infrastructure sector in the country to help India achieve its target for the 12th Five Year Plan.

d. As the capital market regulator, SEBI actively encourages setting of varied frameworks for investment in infrastructure sector so that lack of structures for financing of infrastructure is not an impediment for the development of the sector. Specifically towards this end, SEBI recently notified SEBI (Infrastructure Investment Trusts) Regulations, 2014 to attract more funds in a transparent manner into the infrastructure sector.

e. Other steps taken by SEBI in the recent past towards this end include providing framework for various structures such as, Infrastructure Debt Fund (IDF-MF) under SEBI (Mutual Funds) Regulations, 1996, Category I AIF – Infrastructure Fund under SEBI (Alternative Investment Funds) Regulations, 2012, etc.

f. In addition, SEBI has provided special concessions for companies in infrastructure sector for the purpose of issue and listing of securities under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. SEBI has also simplified the procedure for public issue of bonds which has facilitated bond offerings of several infrastructure companies. Additionally, SEBI also has a framework for public offer and listing of securitised debt instruments under SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.

g. For removing any hindrance for investment in the infrastructure sector through the FVCI route and to boost the infrastructure sector in the country, it is proposed that FVCIs may be allowed to invest in CICs investing in the infrastructure companies.

h. The proposal also is based on the fact that CICs are essentially holding companies and do not engage in financing activity similar to other NBFCs and therefore do not go against the intent of the FVCI Regulations of not allowing FVCI investment in non-banking financial services.

i. The proposal is expected to infuse funds into the infrastructure sector which is crucial for development of the country and has vast positive spillover effects over various other sectors and the entire economy.

j. This proposal to allow investment by FVCIs in CICs investing in infrastructure companies has also been endorsed by the Government of India and Reserve Bank of India. The proposal is one of the recommendations of High Level Committee on Financing of Infrastructure.

k. In addition to the above, in line with reclassification of NBFCs by RBI over the last decade, it is proposed that the negative list under Schedule III of the FVCI Regulations is suitably modified to replace 'equipment leasing and hire purchase companies' with 'Asset Finance Companies and Infrastructure Finance Companies'.

4. PUBLIC COMMENTS

In the light of the above, SEBI proposes to make suitable amendments as may be required for FVCI Regulations. Comments are invited on the above proposals along with rationale for the same. Comments may be forwarded by email to Ms. Nila Salil Khanolkar, Assistant General Manager at nila@sebi.gov.in or to Mr. Aditya Sarda, Assistant Manager at adityas@sebi.gov.in latest by November 15, 2014 in the following format:

Name and organization:			
Sr. No	**Pertains to**	**Recommendation**	**Rationale**

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