4.1 Approaches to Regulations:

(1) **Unified versus a separate regulatory regime for each constituent of the financial markets** (for example, banks and monetary foundations, insurance companies and the securities markets)\(^\text{225}\). The advocates of the previous contend that it prompts a few profits, for example, economies of scale and more compelling co-appointment and trade of data although the promoters of the recent contend that the brought together regulatory regime exemplified by the Financial Services Authority (FSA) of the UK. The FSA could get solid and bureaucratic establishments unable to react to the fast advancements of the world of finance\(^\text{226}\).

(2) **Self regulation vs. regulation by a regulatory agency belonging to the state:** There is a solid view that when stock trades and other exchange co operations as a Self Regulatory Organizations (SRO) manage themselves they may prompt a more compelling and productive regulation due to the increases for firms from great influence, the closeness of the SRO to the exchange and business sector data and dexterity. Others have contended that organizations recorded on the London Stock Exchange have had a long ethos of great influence that predates the FSA and has been dependent upon the social weights. The casual rules of conduct that constrain self-intrigued conduct yet are not implemented by any legitimate body that can force an authorization, assume a paramount part in social orders where lawful regulatory bodies are powerless. Worries about the viability of stock trades as SRO have revolved around:

(a) their absence of requirement power and subsequently the need for a regulator who can in any event implement (unless they could be bestowed with enforcement authority as suggested) and


the worry that they may be liable to pressure from the constituency that they are expected to regulate\textsuperscript{217}.

Reform of law on the books versus the implementation of law on the ground: The level headed discussion on these issues is more recent and it may be followed over to the improvements in the Soviet Union. The best drafted legitimate codes may not generate the coveted brings about the absence of law. In developing markets, where the little shareholder might not have the same capability to practice his rights, the issues of legislation could be unique in relation to that of nations with an overall created set of lawful institutions. Formal laws brought into a legitimate framework new to and unwelcoming to new laws have been less viable than in nations where the lawful exchange was smoothed by social nearness, lawful adjustment and the accessibility of legal reforms prepared in the requisition of new laws\textsuperscript{218}.

As a sample, in spite of the fact that Russia scores superior to France and Germany regarding investment assurance on the books, its record in corporate regulation on the ground has been short of what agreeable. An expansive meaning of lawful changes which takes into account procedural changes and not only changes of statute, which are more troublesome to force off, can have a significant impact in stimulating economic development by improving the financial system\textsuperscript{219}.

Regulation by the government directly versus regulation by specialized agencies: Through legislation that is subordinate to the parliament, this verbal confrontation basically includes the inquiry of designated or subordinate legislation. The profit of subordinate enactment is that specialized agencies may be depended with the obligation of attaining characterized certain strategy destinations. The agencies might likewise be imagined and organized as an independent organization, free from bureaucratic or political control or impact. They might likewise have the capacity to react to the regulatory needs all the more quickly. The downside may be that such agencies may be more helpless to regulatory capture\textsuperscript{220}.

\begin{footnotesize}
\textsuperscript{217} Ibid
\end{footnotesize}
(5) **Merit Regulation Vs Disclosure Regulation**: This is more a matter of the logic or methodology to regulation. Merit regulation intimates that the regulator accept the part of choosing what is handy for the business. In amazing cases it can include the regulator choosing the quantum, cost and non-value terms and actually timing of an offer of securities, separated from settling on what sort of organizations may get to the business sector. The regime under the Controller of Capital Issues (CCI) that managed the Indian capital business sector preceding the appearance of SEBI may be viewed as a sample of legitimacy regulation. Numerous different nations where open strategy energetically sought after distributive objectives received legitimacy regulation. Divulgence based approach in examination embraces an caveat emptor approach, with the obligation of the regulator being constrained to guaranteeing opportune accessibility of value data from the guarantor and delegates. that could be viewed as sufficient for a sensible individual to make an educated financing or trading decision221.

(6) **Common law versus civil law debate**: The level headed discussion on basic law versus civil law and its effect on administrative frameworks is again later is the key contrasts between the significant legitimate frameworks on the planet. Between 1960 and 1992 normal law nations encountered a little more than 0.5% higher genuine for every capita GDP development than their common law partners. The UK and the USA are the most noteworthy 'cases of basic law nations although Germany, France, Japan and the Netherlands are referred to as illustrations of common law222. These frameworks to diverse political histories of the world in spite of the fact that they developed from the regular starting point of Roman Law; yet they brought about distinctive institutional courses of action with normal law comprising essential of judge made law while common law comprises of classified law. Regular law likewise takes into account more amazing legal self-rule. The option to translate the jurisprudential part of the statute and insusceptibility from managerial impact dissimilar to civil law where the judges have a tendency to demonstration all the more as executives of the law on the books. With some experimental appraisals of the level and nature of assurance accessible to speculators in common law countries. However, caution

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against drawing too much upon the common law tradition and points out that despite their common law traditions of the legal systems of the USA and UK, there might be important differences between the two systems (such as the willingness of the judge to interpret the law more broadly in the USA and the system of litigation which incentivizes more aggressive litigation in the USA). Further, the issue of implementation of law that was pointed out earlier may be more important than the tradition itself in many instances.\textsuperscript{223}

4.2 Regulatory Structure in India

Five agencies have a significant regulatory influence, directly or indirectly, over the securities markets in India currently\textsuperscript{224}. These are

- The Board of Company Law Administration (Company Law Board or CLB) which is responsible for the administration of the Companies Act, 1956\textsuperscript{225}
- The Reserve Bank of India (RBI) which is primarily responsible, \textit{inter alia}, for the supervision of banks and money markets
- Securities and Exchange Board of India (SEBI) which is responsible for the regulation of capital markets and the various participants and activities therein; and
- Department of Economic Affairs (DEA) which is responsible for the economic management of the country and is the arm of the government that is concerned with the orderly functioning of the financial markets as a whole
- Department of Company Affairs (DCA) which is the arm of the government responsible for the administration of incorporated entities.

4.3 Securities Market Regulation prior to SEBI in India

Prior to the formation of SEBI stock exchanges were under the authoritative control of the Stock Exchange Division of Department of External Affairs (DEA). The stock trade division was answerable for the organization of the Securities Contract Regulation Act, 1956

\textsuperscript{224} Ibid
\textsuperscript{225} Constituted under Section 10E Companies Act, 1956
(SCR Act, 1956 henceforth) which represented the business of purchasing, offering and managing in securities.226

The activation or issuance of capital through general society securities business sector or overall was controlled by the Controller of Capital Issues (CCI). The CCI needed to satisfy a few social and budgetary destinations in the release of its capacities, for example:

(i) public investor protection;
(ii) alignment of corporate investments with plan priorities;
(iii) ensuring that the capital structure of companies was sound and in public interest
(iv) ensuring that undue congestion of public issues did not occur in any part of the year;
(v) regulation of foreign investment227.

CCI's method for understanding these goals included (i) micro-administration of the securities issuance process (ii) unified organization and awkward techniques and (iii) Tight controls on quantum of issue, terms (cost and non-value) and actually timing of issue. The CCI administration in this manner spoke to a great example of "merit regulation". The net after effect of the CCI administration was that it (i) hindered asset activation (ii) prompted not so great authoritative practices (iii) brought about the powerlessness of the framework to adapt to the expanding asset assembly stack (iv) prompted the improvement of grey market and subsequent bad advancements in the capital business and (v) gave careful consideration to CCI advancement being developed of business foundations228.

While the CCI seems to have experienced numerous disservices with the profit of knowledge of the past the part of CCI might need to be seen in the connection of the political economy that won around then, with the administration accepting a vast part in the portion of assets, an all-encompassing concern with distributive objectives and the generally lacking level of improvement of organizations that could have upheld a market economy229.

226 Section 4 Securities Contract Regulation Act, 1956
227 Under the provisions of Controller of Capital Issues
228 Ibid
229 Ibid
4.4 Role of Regulation: A Framework

There are numerous points of view from which the justification for regulation may be inspected. The system inside which we propose to look at the part and movement of SEBI so far is explained beneath. The framework expands upon the essential part and working of the fiscal markets as talked about in most standard reading material on the subject230.

One of the key parts of a business is to encourage the valuing of advantages. This obliges the stream of value data rapidly and in an expense and effective way. In the setting of the financial market this means quality by the exactness and timeliness of information. Information has open great attributes and henceforth it is paramount to guarantee that it is transformed in sufficient amount to ensure proper pricing of assets231.

The second key part of the monetary markets is to give liquidity to stake managers. Liquidity emerges from exchange. Exchange may be spurred by a few contemplations, for example, supporting danger, speculative thought processes and worth trade. Merchants have two primary concerns when they consider investment in the business: Transaction Cost and Counterparty Risk232.

To begin with, brokers need to make sure that the esteem that they trade is short of what the expense of taking part in the exchange. This expense extensively as transaction cost. Transaction cost may involve the requisitions payable to exchange facilitators, for example, agents, expense of trusts obstructed in the exchange because of the time taken to transcendent the exchange and from that point for the resources for change hands, because of postponements in exchange and settlement methodology on that market and different expenses, if any, for example, stamp duty. Transaction cost could additionally be by virtue of the pursuit and data expense of purchaser discovering merchant. A third component of transaction expense may be because of impact costs. The impact costs emerge because of unfriendly development in cost of advantages because of low liquidity levels in the business sector. Minimizing transaction cost is not by any means the duty of the regulator. Intense drives in the business (as between commercial centers or trades) could likewise be required to achieve lessening in transaction costs. However in circumstances where the businesses are as of now creating and are controlled by an aggregation of settled in diversions and transaction costs are upheld at more elevated amounts, (bringing about easier levels of equilibrium),

231 Ibid
232 Ibid
approach intercession regarding regulatory ordering of institutional changes that will help diminish transaction costs might be essential\textsuperscript{233}.

Second, traders need to make sure that the transaction could be finished without any danger of default. We allude to this danger comprehensively as counterparty risk. Counterparty risk may emerge because of the absence of impetuses for one of the gatherings in the transaction not to satisfy his exchange commitment. It might additionally emerge because of elements outside the ability to control of the exchanging gatherings because of crises in the business, for example, interim or perpetual shutting down of the business sector, or a business sector wide installment emergency etc. Counterparty risks may be moderated through private contracting. However that might be an expensive methodology and might add to the transaction costs. Regulation is an elective to private getting that gives a set of standards of engagement and an expense of rebelliousness and therefore can alleviate counterparty risks\textsuperscript{234}.

Thirdly, financial markets have several agency relationships: Between investors and administration of the issuer company, between merchant and customer, between representative and sub-specialist and between stock trade proprietorship, its management and the brokers and dealers exchanging on the trade. Determining the clashes in these company connections through private dealing may not be simply wasteful additionally infeasible basically because of the complex nature of large portions of these connections. An regulatory framework can likewise help relieve some of these org clashes\textsuperscript{235}.

Common regulatory methods for determining the agency conflicts, for eg., are guaranteeing compelling divulgence and also forms which will guarantee that the issuer or the exchange may not set up unreasonable obstructions to allocations and transfer of securities. With the end goal of comprehension the institutional and regulatory perspectives financial markets may be isolated into primary and secondary markets. Primary markets embody open offerings of the organization securities or the first run through, otherwise called Initial Public Offerings or IPO. An IPO comprises of securities issued by the company to raise cash flow to help the company or offer of securities by existing investors for

\textsuperscript{233} Brierley E.C. and David R., \textit{Major Legal Systems in the World Today: An Introduction to the Comparative Study of Law}, p. 278, 2009

\textsuperscript{234} Ibid

\textsuperscript{235} Ibid
accomplishing liquidity on their financing. Initial public offerings might likewise include offering of securities by shareholders of the company searching for liquidity.\textsuperscript{236}

The recognizing characteristic of an IPO contrasted with an ensuing offering that the securities are sold to general society despite any precedent to the contrary. This is the reason that they are alluded to as unseasoned offerings. Initial public offerings stances have an intriguing informational issue to the economist. Primary markets additionally incorporate consequent offerings after the IPO as rights issues or further open issue of securities by the company, otherwise called subsequent offerings. Secondary markets, unexpectedly, include purchasing, offering or managing in securities that have been issued by the company and allotted to some subscribers. Secondary markets are basically a system of liquidity for investors in securities. They assume a just as significant part in running across the cost of the security, in esteeming the firm and in risk management through instruments of prospects and subordinates. The economic institutional and operational issues identifying with the two sections of the capital business are very unique from one another. Overlaps exist between the two fragments as far as the qualities recently discussed about.\textsuperscript{237}

4.5 The legal levers that SEBI Operates

The two pieces of statute that SEBI draws upon to discharge its statutory roles, these are the Securities and Exchange Board of India Act, 1992 (SEBI Act hereafter) and the Securities Contract Regulation Act, 1956 and the rules made there under.\textsuperscript{238}

4.5.1 Securities and Exchange Board of India (SEBI) Act 1992

SEBI was brought into presence by the Securities and Exchange Board of India Act, 1992 (the SEBI Act, from this point forward), which became effective on January 30, 1992. The preamble to the Act portrays the reason for the Act in wide terms as "an act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto". The provisions of the SEBI Act characterize its part in more particular terms these comprehensively identify with: (i) Regulating the business in stock exchanges and any other securities markets (ii) Registration and regulation of a range of financial intermediaries and trade participants (iii) Prohibiting practices that are considered to

\textsuperscript{237} Ibid
\textsuperscript{238} Financial Law Reporter, Issue No. 2, p. 27, 2011
\textsuperscript{239} Section 2(11) SEBI Act 1992
be unhealthy for development of the securities market such as insider trading fraudulent and unfair trade practices for promoting and regulating self regulatory organisations (iv) Promoting investors education and training of intermediaries of securities markets (v) Inspection and calling for information from various regulated entities referred to in (ii) above (vi) Conducting research (viii) Collecting fees or other charges for carrying out the purposes of this section and (ix) Performing such other functions as may be prescribed

Then again, the procurement states at the beginning, while depicting these territories that the spelling out of specifics regions of concern are without bias to the all inclusive statement of the prior some piece of the area. In this way ought to SEBI find that improvement of a specific aspect of the business sector is significant for its advancement ought to might be at freedom to worry about that feature suo motu, despite the fact that that has not been spelt out in the zones over that are of concern to SEBI.

4.5.1.1 Scope and source of SEBI's authority

The wide scope of these forces may be seen from three different viewpoints. To begin with, SEBI is engaged to perform such capacities and practicing such controls under the provisions of the SCR Act as may be designated to it by the central government. Secondly, the SEBI Act leaves open the space for SEBI to perform such different capacities as may be endorsed.

The other important source from which SEBI draws power is from the Companies Act which enables SEBI to manage various provisions of the Companies Act insofar as they identify with issue and exchange of securities and non-payment of dividend in the case of listed companies, as well as those public companies which intend to get their securities listed on any stock exchange. Further, unlisted companies are presently permitted to rundown their debt securities without listing their equity securities. Thus the provisions of the Companies Act to be directed by SEBI will now stretch out to those companies whose debt securities are recorded regardless of the possibility that their value shares may be nearly

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240 Ibid
241 Ibid
242 Section 11(2) of SEBI Act, 1992
243 Section 11(2) (j)of SEBI Act, 1992
244 Section 55A of the Companies Act 1956
245 The sections identified are Sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121,122,206, 206A and 207 of the Companies Act.
246 Regulation 8.2 of SEBI (Disclosure and Investor Protection) Guidelines, 2000 as amended 10 S 67(3) of Companies Act 2013
held, ought to these companies be acknowledged as listed companies as for sure they should be. Companies which propose to grow their value shareholder base to more than fifty members will be regarded to have made an public offer. Accordingly companies which have more than fifty members ought to fall under the regulatory purview of SEBI since all companies that aim to make public offer are obliged to get their shares listed on a recognized stock exchange.\footnote{Ibid}

The sections of the Companies Act\footnote{Section 117 Companies Act 2013} above identify with method for issue of prospectus, and the contents mandated by the company law, authorization and responsibility of those approving the issue of the outline, system for allotment of shares and debentures, payment of brokerage and commission, buyback of shares, issue of shares at a premium or rebate, further issue of capital (rights or generally), issue and recovery of inclination offer capital, organization of offer capital, (for example, numbering, declarations etc) exchange of shares and affirmation of shares, procurements identifying with issue of debentures and security of debenture holders, for example, production of trust and reclamation store and installment of profit. These areas about legislate the capital assembly transform (issuance of capital), liquidity creation methodology (exchange) and the acknowledgment of return (profit), the three important aspects of the issuer's relationship with investors. It is worth bringing up that these principal angles are legislated by the Companies Act and SEBI is just assuming the part of a head of these provisions insofar as they identify with listed companies.\footnote{Ganguli A.K., Legal issues involved in transactions in the globalize capital market, International Journal of Disclosure and Governance, Volume 7, p. 148-156, 2008}

The sections of the Companies Act above relate to procedure for issue of prospectus, and the contents mandated by the company law, authorization and responsibility of those authorizing the issue of the prospectus, procedure for allotment of shares and debentures, payment of brokerage and commission, buyback of shares, issue of shares at a premium or discount, further issue of capital (rights or otherwise), issue and redemption of preference share capital, administration of share capital (such as numbering, certificates and so on) transfer of shares and certification of shares, provisions relating to issue of debentures and protection of debenture holders such as creation of trust and redemption reserve and payment of dividend. These sections pretty much govern the capital mobilization process (issuance of capital), liquidity creation process (transfer) and the realization of return (dividend), the three\footnote{Ibid}
important aspects of the issuer's relationship with investors. It is worth pointing out that these fundamental aspects are governed by the Companies Act and SEBI is merely playing the role of an administrator of these provisions insofar as they relate to listed companies250.

4.5.1.2 SEBI regulatory strategy

The principal approaches resorted to by SEBI for achieving its objectives as a regulator are (i) Registration and licensing of market participants (other than investors) (ii) Mandating disclosure of information by issuers, various intermediaries and participants (iii) Making rules governing the conduct of market participants (iv) Enforcement of compliance with the rules through (a) Collection of information (b) Inspection of intermediaries' business and records (c) Penal action against errant participants, where appropriate or necessary (v) Market development initiatives (vi) Investor protection and education initiatives251.

4.5.1.3 Registration and Certification

The SEBI Act gives that no stockbroker, sub-agent and such other middle person who may be connected with the securities market should purchase, offer or deal in securities with the exception of under and as per the terms of the certificate of registration. Intermediaries subject to the authorizing procedure of SEBI incorporate include depositories, depository participants, custodians, credit rating agencies, mutual funds, venture capital funds, foreign institutional investors and collective investment schemes and the buying, selling and dealing of securities. SEBI has developed guidelines and regulations administering every one of these mediators or members under which the firm gets enlisted. Regularly these regulations additionally define conditions identifying with the size, capital amleness, business behavior, record keeping etc252.

4.5.1.4 Mandating disclosure of information

SEBI drives exposure through the stock exchanges primarily. Three reasons may be progressed energetic about SEBI driving the exposure in this respect through stock exchanges. For quite a while before the approach of SEBI issuers had been giving some measure of occasional money related data to stock exchanges as a part of their listing obligations. It boded well for proceed with that approach253.

250 Ibid
251 Section 11SEBI Act 1992
252 Ibid
253 Ibid
Second, by definition, generally these things of data are value delicate. Expedient spread of such data is critical. Stock exchanges are prone to be preferable prepared over SEBI to spread this data. Thirdly, it is a step towards setting up the stock exchanges to develop into being SRO, or at any rate permitting more regulatory action to decline in the support of stock exchanges\textsuperscript{254}.

The data to be generated at the time of an essential issue is legislated by the Companies Act which is constantly now regulated by SEBI. The revelation necessities in the plan and offer records identifying with rights issues by and large further expand on the prerequisites of the Companies Act. SEBI further obliges intermediaries connected with the capital markets to give data identified with the transactions that they are connected with, consistence with which is compulsory. A significant part of the data that is processed in consistence with the regulations is, for example, to empower the regulator and alternate members in the exchange to create a complete picture of business inclination for different elective ventures. Without regulatory impulse on members in the business there might be under-handling of data as has been witnessed in the case of market for privately placed debt\textsuperscript{255}.

4.5.1.5 Making rules and Issuing Directions

This is a standout amongst the most critical parts of SEBI's working as such. The SCR Act and Rules and the SEBI Act are empowering statutes that engage SEBI to make guidelines and regulations boosting welfare either proactively or because of advancements in the market that conceivably challenge the working of the business instrument. The SEBI Act accommodates SEBI "to make regulations reliable with this Act and the principles made there under to complete the reasons of this Act."\textsuperscript{256}

An extensive variety of forces has additionally been designated by the Central Government to SEBI under the SCR Act\textsuperscript{257}. All the standards and regulations made by SEBI representing the exercises of the different capital business members have all been under the principle making powers under this Act aside from on account of the Depositories Act, 1996\textsuperscript{258}.

\textsuperscript{254} Ibid
\textsuperscript{255} Ibid
\textsuperscript{256} Section 30 of SEBI Act, 1992
\textsuperscript{257} Section 29A of SCR Act
\textsuperscript{258} Section 11, 11A and 30 of SEBI Act
Apart from these forces to make rules, SEBI might additionally issue bearings every now and then SEBI may issue directions to the intermediaries in the market as well as issuers so as to protect investors or to ensure proper management of the intermediary’s affairs. SEBI has utilized the ability to issue directions and rules widely over various occurrences.

4.5.1.6 Compliance Enforcement

Notwithstanding being equipped with forces to implement agreeability with the guidelines and regulations that it makes it has been perceived that how SEBI has been given forces to manage the significant parts of the Companies Act and SCR Act. For example, SEBI is enabled to complete investigation of listed companies to the degree that it is important for that it is necessary for enforcement of the provisions that it is responsible for. SEBI is empowered to lodge a complaint to initiate legal proceedings in a court against listed company in respect of the provisions of the Companies Act that it is responsible for.

The forces of authorization that SEBI has against the stock exchanges under the SEBI Act, the Board has the ability to call for occasional data and attempt standard or one-off investigations of the books of delegates, records offices, also premises, reviews and request. These forces are additionally exercisable under the provisions of distinctive standards and regulations. In case the books and records obliged are not made accessible by the issuer by the intermediaries or issuer concerned SEBI may seek permission from a first class magistrate to enter the premises of the business concerned and seize such records as necessary. During the course of an investigation SEBI is engaged to call for data and record explanations from any bank or whatever viable institution built under a state, focal or commonplace statute insofar as it identifies with a transaction in securities, which is under investigation. SEBI’s data gathering exercises go past these formal and authority directs as on account of pubic issues for eg., where it assembles data from a mixed bag of other non official sources.

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259 Section 11 B of SEBI Act.
260 Section 209 of Companies Act, 1956
261 Section 621 of Companies Act
262 Section 11 (2) (i) of SEBI Act
263 Power to inspect the books of a company under grounds of suspected trading or unfair trading practices are exercisable under Section 11 (2) of SEBI Act.
264 Section 11 (8) of SEBI Act
265 Section 11 (2) (ia) of SEBI Act.
266 SEBI Annual Report 1993-94
On the off chance that the data social affair, request or investigation activities uncover resistance with the provisions of the SEBI Act, guidelines or regulations, SEBI has controls under the SEBI Act and also unique standards and regulations to implement agreeability, hinder proceeded or further rebelliousness or cure any ruptures in the consistence through an arrangement of measures running from passing strictures and issuing warnings to the resistant member, to implementing inversion of noncompliance to burden of fines, suspension of mediator from the business sector, wiping out of licenses or in occasions of grave violation to indict the violator and grant disciplines including imprisonment\(^\text{267}\).

In the event that a request uncovers violations of SEBI's regulations by a intermediary or SEBI has sensible grounds to accept that a guarantor who is going to get its, securities recorded on a stock trade has enjoyed business sector control or insider exchanging, which need to be promptly checked, SEBI may issue "cease and desist orders"\(^\text{268}\). As a crisis measure, pending the examination or consummation of request SEBI may request the suspension of exchanging of a security on a stock trade, limit persons from getting to the securities market, purchase offer or arrangement in securities or suspend office bearer(s) of stock trades or SROs, appropriate or hold securities underlying the transaction being explored or connect financial balances with authoritative consent\(^\text{269}\). The synopsis nature of these forces may seem additional normal and impressive regarding degree and impact; yet acknowledging the rate with which money related markets respond to data and occasions and the criticality of regulating certainty in the business as far as appropriating or halting proceeded damage to investors and other business members, velocity and adequacy of obstacle movement are imperative and these provisions empower quick prevention. At last, the SEBI Act accommodates a set of financial punishments for the vast majority of the real violations of the regulations\(^\text{270}\).

It is intriguing to note that the SEBI Act may be one of the few laws, if by all account not the only one, that accommodates spewing of benefits made out of practices that violate the law\(^\text{271}\). In a fascinating differentiation, the most extreme fiscal punishment under the Companies Act is Rs 50,000 after the punishments were as of late expanded hundred fold. One conceivable defense for the distinction in the money related punishments is that on

\(^{267}\) SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002

\(^{268}\) Section 11D of SEBI Act.

\(^{269}\) Section 11 (4) of SEBI Act

\(^{270}\) Section 15A to Section 15HB of SEBI Act

\(^{271}\) Section 15HA of SEBI Act which levies penalty for fraudulent and unfair trade practices
account of listed companies the misfortune of welfare ensuing to a violation could be of bigger monetary size and if left undaunted can prompt a descending winding in the fiscal markets. The destination in ejecting profits procured through illegitimate methods is not to restore the influenced speculators to their prior levels of welfare; for the returns of these punishments are credited to the Consolidated Fund of India272. These punishments might hence have all the earmarks of being intended to take away the investment impetuses from these violations273.

To implement the forces vested under the SEBI Act and a large number of the related regulations, including the Depositories Act, 1996. SEBI has the forces of a Civil Court under the SEBI Act. The regulations detail an uniform set of systems to be taken after over the whole set of SEBI related or SEBI made guidelines and regulations274.

4.5.2 The Securities Contract Regulation Act and Rules

Trade securities in India has been directed basically through the Securities Contract Regulation Act, 1956 (14 of 1956) (SCR Act, from now on) and the rules made there under, the Securities Contract Regulation Rules, 1956 (SCR Rules, henceforth). The object of the SCR Act is to accommodate the regulation of stock exchanges and of securities managed in on them with a perspective to averting undesirable hypothesis in them. It likewise looks to manage the purchasing and offering of securities outside stock exchanges through its different provisions. The post war blast in the stock exchanges between 1945 and 1946 and its fallout stressed the earnestness of stock exchange change on an all-India foundation. Two changes in 1995 and 1999 achieved a few vital progressions to the extension and the organization of the SCR Act, bringing about the current type of the law275.

Together with the SCR Act, the SCR Rules give the fundamental legitimate schema to the regulation of the securities showcase in India, while the Companies Act gives the lawful system to the regulation of body corporates in India276. The law has a comprehensive and expansive meaning of "securities" as "shares, scrip, securities, debentures, debenture stock or other attractive securities of a like nature" and spreads subsidiaries, units of group venture plans, (for example, common trusts) and government securities. Courts have translated the expression "marketable" to incorporate imparts that are unreservedly transferable regardless

272 Section 15 JA of SEBI Act.
273 Ibid
274 As under the powers of Code Civil Procedure, 1908
276 Ibid
of the fact that they are not recorded on a stock exchange. Further, the SCR Act manages contracts in securities and consequently those companies that schedule just their debt securities without posting their equity instruments\(^\text{277}\) might fall under the regulatory purview of the SCR Act. The essential components of the regulatory part of SCR Act are: (i) Limiting and disallowing contracts in securities to def electorates, geological zones or trading forums (ii) Licensing of stock exchanges (iii) Controlling of stock exchanges (iv) Regulating Issuer Conduct and (v) Control over the Listing Agreement\(^\text{278}\).

The SCR Act particularly distinguishes a couple of offenses, which are regarded to be a cognizable offense under the Code of Criminal Procedure.\(^\text{279}\) The offenses are unwillingness to co-work in an examination by the central legislature of the issues of a stock exchange,\(^\text{280}\) contracting in contradiction of the confinements in specific ranges or limitations on specific sorts of agreement talked about prior\(^\text{281}\), owning or dealing with a spot with the end goal of carrying on exchanging securities other than a distinguished stock exchange or get-together at a spot other than the spot of business specified in the bye-laws of the stock exchange, and prompting People that they can contribute through oneself or promoting for securities business when one is not a part of a distinguished stock trade or a merchant authorized under the SCR Act. These offenses might be rebuffed with detainment of up to one year or fine or both\(^\text{282}\).

4.5.2.1 Analysis of the provisions of the SCR Act

At present giving the permit SEBI is relied upon to guarantee that the inquirer has the framework and that its contract records, for example, the bye-laws have provisions to lead the business of securities exchanging an efficient way. The bye-laws give the order to the stock exchange to casing fitting manages, the kind of request framework that the trade may receive, principles for capabilities for handles, the sort of exchanging frameworks that the exchange may embrace, clearing and settlement strategies, criteria for posting etc. The bye-laws engage the stock exchange to manage the issue of counter-party risks in an assortment of ways. By giving a system of rules that manage the issue of defaults and strategy for managing defaults,

\(^{277}\) Under Regulation 8.2 of the Disclosure and Investor Protection Guidelines 2000, as amended
\(^{278}\) Ibid
\(^{279}\) Section 25 of SCR Act
\(^{280}\) Section 6 (4) of SCR Act
\(^{281}\) Section 13 of SCR Act
\(^{282}\) Section 16 of SCR Act
(for example, selling of defaulting parties position) the bye-laws can mitigate counter-party risks at individual trader’s level\textsuperscript{283}.

By accommodating suitable framework of rules of exchanges executed by brokers for customers, the exchange can enhance the certainty level of investors exchanging on that exchange. Exchange level emergencies may be kept away from by accommodating margining frameworks, following the position of brokers and dealers so as not to give them a chance to assemble positions that can build the risk of exchange level default and accommodating a settlement and exchange insurance finance that will minimize the risk of misfortune because of an exchange wide emergency. Notionally, the bye-laws as accommodated on the books take into account an extraordinary arrangement of separation around the exchanges. Notwithstanding, on account of exchanging and settlement frameworks, by practicing its powers to alter the bye-laws SEBI has been setting least models for the exchanges on large portions of these issues as such\textsuperscript{284}.

Thus, in the range of information disclosure SEBI has driven the substance and the recurrence of the nonstop exposure administration as may be perceived from the examination on the posting understanding above. Immediate scattering of related data is currently conceivable now on account of data innovation. Divulgence by issuers at the time of listing generally involves the revelation in the outline since the listing agreements require a greater amount of steady documentation, for example, duplicates of agreement and records and does not require much extra substantive substance without anyone else present that is not officially included in the prospectus or offer document\textsuperscript{285}.

At the trading level the exchange can minimize cases of trading on or off business sector transactions which may bring about deficient information moving through to whatever is left of the business sector. The exchange might on its own or under a SEBI directive restrict certain particular sorts of trading or trading practices in the event that they ruin the stream of information and hence or overall influence the microstructure of the business sector. For example, SEBI regulated that block trades which were getting executed outside the market trading mechanism be directed through the electronic exchanging frameworks of the stock exchange so that the data may be consumed quickly by the business. The exchange might additionally put resources into business sector observation frameworks which could

\textsuperscript{283} Ibid
\textsuperscript{284} Ibid
\textsuperscript{285} Ibid
help recognize insider trading or business control transactions. The SEBI has played in the improvement of the stream of data identifying with issuance of securities and exchanging in essential markets and in the exchanging and settlement frameworks286.

Transaction costs, as we noted prior, earlier of immediate expenses, for example, financier and backhanded expenses, for example, illegitimate increases of the broker in not passing on the profits of the best cost or in basically distorting the buy or deal cost of the request, the expense of stores hindered because of the settlement cycles or deferrals at the backer's end in postponing or misusing the exchange of securities. The bye-laws give enough influence to settle financier rates, structure operational methodology and decides that will drive brokers to be transparent with the customer regarding the break-up of the buy cost and the financier in the agreement note and introducing an electronic exchanging framework which will help the customer guarantee that the cost of his trade has not been distorted to him by the agent. The minimum offer to the public and conditions for kept posting basically are pointed at guaranteeing a at ensuring a minimum floating stock of the company's securities in the market A minimum non-promoter holding does not clearly guarantee the level of liquidity that is obliged to cut down impact costs. In any case, it is a first venture in that course. Stock trades could additionally take a gander at other liquidity upgrade measures, for example, business sector making that will diminish impact costs. These are inside the purview of the exchange’s business approaches. The Over the Counter Exchange of India (OTCEI), for example has constantly obliged guarantors to accommodate at any rate market producers, with some minimum execution conditions tossed in287.

The provisions of the SCR rules identifying with allocation and transfer of shares, book conclusion dates, relinquishing of profits, techniques for managing damaged requisitions for trade, issue of double testaments along these lines on are steps to guarantee that the management of the company does not abuse the trade and trade or assignment procedure to their profit and the disadvantage of the investor. Market control, formation of a false market and value fixing by promoters and manager directors of companies took after by dumping of share, creating misfortunes to the outsider investor could be relieved by the following of trading examples with the assistance of observation frameworks specified prior and a set of deterrent punishments. End of participation of the intermediaries and withdrawal of posting for the securities of the reprobate backer are two compelling alternatives that are

286 Ibid
287 Ibid

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well inside the ambit of the bye-laws of stock exchanges. The agency issues between merchants and their customers have been talked about as a feature of the transaction cost. There could be clashes between sub-brokers and the main brokers. The bye-laws permit exchange to frame rules that will make it exorbitant for sub-brokers to act against the enthusiasm of the fundamental agent and subsequently moderate a portion of the agency issues.\textsuperscript{288}

In short, the SCR Act does, straightforwardly and also in a roundabout way, addresses the different issues or issues that could possibly come in the method for the stock exchange assuming its part as a business sector for securities. The regulation leaves enough adaptability with the exchanges to make rules which will moderate the issues at the level of unique exchanges. It does however engage SEBI to screen if exchanges assume that part and where they don't it engages SEBI to impact them to do thus, or ought to the circumstances request even control them to do so with the risk that disappointment to follow the directive could welcome reformatory activity from an extent of impediment measures that SEBI has at its order.\textsuperscript{289}

4.6 SEBI’S Regulatory Performance – Two Instances

Since its inception in 1992, SEBI has been heartily occupied with creating the regulatory structure and also creating new institutions or redesigning the existing foundations to enhance the working of the capital markets. In the past segment we alluded to the arrangement of standards and regulations making activities of SEBI.\textsuperscript{290}

The standard making action of SEBI so far is abridged in the table underneath. The table records the delegate or capital business action looked to be managed by each of these separate guidelines as well as regulations.\textsuperscript{291}

\textsuperscript{288} Ibid
\textsuperscript{289} Ibid
\textsuperscript{290} SEBI [1994]: Securities and Exchange Board of India Annual Report for 1993-94
\textsuperscript{291} Ibid
Following the advancement of these rules and regulations throughout the years can offer experiences into the methodology underlying the same, received by SEBI. The improvement of the guidelines overseeing people in general issues by companies, all the more especially, the public issue of equity shares and the some of the key developments in the secondary market. The accentuation here is on the significant improvements and patterns in the development instead of particulars292.

The SEBI yearly reports give a review of the strategy making exercises of SEBI throughout the year under survey. In a few occurrences the investigation calls for the attention to inquiries of an observational nature that might require examination to create the reasons accomplished by the regulation being referred for the investigation293.

The improvements in general society issue of value imparts along the accompanying lines294:

Regulation of Disclosures: The development of the key revelation prerequisites for companies planning to make a public issue.

292 SEBI [1995]: Securities and Exchange Board of India Annual Report for 1994-95
293 Ibid
Access Criteria: These are criteria connected by the regulator to screen issuers that can make an public issue. Dissimilar to on account of revelations, access criteria may be said to mutilate the business sector instrument in that the investor’s chance set is falsely obliged or constrained by the regulator.

Issue Mechanism: This arrangements with institutional systems put set up by the regulator to guarantee that (i) The issue methodology permits better disclosure of price and demand for the shares and (ii) The assignment instrument meets the sought budgetary or social targets.

Pricing: A conclusion of the issue instrument, pricing is no doubt talked about independently on the grounds that customarily evaluating of securities has been managed in the past in India to accomplish social objectives.

Bonding: The provisions which may guarantee that the management of firms or the manager directors as the case may be bond themselves to satisfy the agreement implied between the investors in a company and the management. One might need that the average instrument might include a few intends to adjust the premiums of the management to that of the investor or the profits of the owner-manager or insider shareholder to that of the external investor.295

Certification: Ensuring compliance with the regulations through a methodology of checking and punishing rebelliousness might be an expensive procedure for the regulator and in the end will unfavorably affect the welfare of the social order that is proposed to profit from the regulation. An administration of certificate by intermediary who take part in the business, sponsored by a proper set of impetuses, for example, replenishment of the middle person's permit to participate good to go, in exchange for consistent conduct, could be an appointed and more practical method for guaranteeing consistence296.

The advancement in the secondary market is along the lines of the following framework:

Trading and Settlement Systems: The regulatory initiatives of SEBI enhances the trading and settlement frameworks in the different stock exchanges and their effect on the transparency of the framework, effectiveness as far as minimizing transaction cost and decreasing counterparty risk.

296 Ibid
Dematerialization: The effect of dematerialization cuts crosswise over stock exchanges and likewise affects the securities showcase in a more extensive sense.

Continuing Disclosure: The territory of proceeding divulgence by recorded organizations has seen tremendous change under SEBI's regulatory regime.

4.6.1 Regulation of Disclosures

Throughout the initial five years paving the way to 1995-96, SEBI seems to have centered to a huge degree on the primary markets, particularly on disclosure and regulation of intermediaries connected with the business sector and on the administration of stock exchanges. The first Disclosure and Investor Protection Guidelines were announced in December 1992. The fundamental changes in the revelation administration throughout the year identified with notice of premium according to the past CCI estimating recipe as a benchmark. Divulgence to bring out the guarantees held out by the promoters in the past against the real execution, way of venture and organization of issue returns recorded stock costs to bring out the validity of business sector cost and probability of price rigging. In 1993-94, SEBI proclaimed a code of advertisement and obliged that issue related notices needed to stress highlights and dangers in equivalent way.

The main real activity to realize a generous change in divulgence levels contrasted with the past was in 1995-96. SEBI's yearly report for 1995-96 expressed "the vital center of the exercises were on enhancing the disclosure standards". The trigger seems to have been "the quantitative development of the business and the flexibility to share issues had likewise raised inquiries regarding the nature of issues entering the business sector. The new disclosure regime actualized almost totally the proposals of the Committee known as the "Malegam Committee." Broadly, the suggestions obliged revelation of preissue costs and method for financing for the same, extension credits if any to be fast from the issue, break-up of turnover item businesswise, conformities for disclosure holds on the benefits and in addition the stores in the issuer’s balance sheet, shareholding of promoters and directors of promoter company, points of interest of specialized and fiscal - cooperation, points of interest of curious or occasional occasions or transactions which are liable to influence wage from proceeding operations, quantification of impact of evaluators' capabilities and

\[297\]
\[298\]

Ibid
Ibid

96
administration's discourse of fiscal conditions and operations as reflected in money related explanations\textsuperscript{299}.

Monetary projections were permitted just on account of new organizations or ventures and generous extensions. The notice code was further reinforced to keep commercials from the time of receipt of the acknowledgement card till receipt of the base membership was affirmed by the dealer investor. As a measure of further upgrading the transparency levels the draft plan was obliged to be made accessible to the general population on the loose. These revelations extended the scope as well as give a better determination picture of the investor's business and budgetary execution, including monetary projections where there is no verifiable execution to fall once again upon\textsuperscript{300}.

The following round of revelation related corrections was published in 2000-01. These necessities included subtle elements of usage of trusts raised from promoters and different reservations and firm portions, investment of the same where it has not been completely used. The new prerequisites disallowed budgetary projections in all cases, as opposed to the Malegam Committee suggestions. Issuer companies were obliged to legitimize the cost dependent upon budgetary degrees; if the cost was not supported the issue might not be permitted to move ahead\textsuperscript{301}.

On account of book-built issues could be drifted at the cost dependent upon interest from Qualified Institutional Brokers (QIB), subsequently giving an added playing point to book-built. The accentuation in this round of extra divulgence necessities has been on supporting the cost on the premise of authentic money related proportions or on the foundation of value evaluated by the QIB, rather than fiscal projections. To guarantee a level playing field around institutional moguls and retail gurus SEBI restricted the data in exploration reports to data that was accessible in the offer report, once perceptions from SEBI were gained on the offer archive. The necessity of equivalent accentuation on risks and also highlights would apply to research reports to the extent that they did to commercials. The offer record was to hold just a floor cost and not a most extreme or a run so that the investors might not be affected by the cost demonstrated in the offer document\textsuperscript{302}.

\textsuperscript{299}SEBI [1996]: Securities and Exchange Board of India Annual Report for 1997-98
\textsuperscript{300}Ibid
\textsuperscript{301}Ibid
\textsuperscript{302}SEBI [1996]: Securities and Exchange Board of India Annual Report for 2002-03
4.6.2 Access Criteria

The early set of access criteria declared by SEBI as a major aspect of the DIPG 1992 permitted each company to make a public issue as long as it fulfilled the criteria of the stock exchanges. The distinction between a company with a profitable track record (or companies where more than half of the paid up value capital was held by companies which had a profitable track record) and that without a track record was just that the previous classification of companies could charge a premium for the shares. Nonetheless, as the SEBI Annual Report for 1995-96 exceptional, this brought about a substantial surge of public issues.\(^\text{303}\)

In light of this, SEBI made the right to gain entrance criteria more stringent by obliging a three year profit record throughout the latest five years for a company to make a public issue and a minimum total assets of Rs 1 crore to have been supported throughout the latest three years, falling flat which the company might require a confirmation by having its anticipate assessed by a bank. On the other hand a fiscal foundation and getting money related help to the degree of 5% of the task cost from the evaluating bank. These criteria would apply to even those companies which were at that point recorded yet proposed to make a public issue substantial enough to build its post issue value to more than five times the pre-equity capital.\(^\text{304}\)

The profit installment record was soon changed to capacity to pay profit, because of investor representations that the profit installment record was excessively cruel. The profit installment capability was likewise inevitably traded with the current necessity of a benefit record in 2000-01. The SEBI Annual report for that year additionally distinguished that the exchange foundation of guaranteeing issues of a base quality entered the business, specifically; requiring investment of 5% by a fiscal establishment or bank that evaluates the venture was carried out away with. Rather, issues that finished not fulfill the new gainfulness record basis or companies whose post issue value surpassed the pre-issue value by five times or more were obliged to book assemble their issues with no less than 60% of the offer to people in general being subscribed to by QIB. The reason for this necessity, as stated by the yearly report, was that through this course retail investors got to partake in issues which had

\(^{303}\) Ibid
\(^{304}\) Ibid
been assessed by and at the same cost as institutional investors who seem to be, on normal, seemingly preferable educated and gifted over retail investors\textsuperscript{305}.

It must be noted that notwithstanding these right to gain entrance criteria of SEBI singular stock exchange have their winning criteria. The profit or benefit prerequisite, separated from giving proof of the monetary feasibility of the investor, likewise guarantees that the investor has chronicled information base wear which he can survey the prospects for the investment. The utility for the total assets prerequisite or the paid up capital necessity of the stock trade is not promptly clear. One description could be that SEBI and also the stock exchange think about size (for which paid up capital and total assets may be substitutes) as a pointer of the imaginable money related heartiness of the issuer\textsuperscript{306}.

However there has all the earmarks of being no constraining confirmation from mechanical association to that impact, a great deal less to recommend what could be a "safe" least estimate and imagine a scenario in which any could be a suitable measure for size. Regardless there seems, by all accounts, to be no known exact confirmation from the Indian connection that evaluates the effect of these right to gain entrance criteria on the nature of the issuer who raise capital from general society securities showcase\textsuperscript{307}.

The other conceivable description could be that separated from more stupendous money related strength, recorded organizations additionally need to be of a base size so they may have the capacity to put resources into the association and frameworks important to meet the compulsory disclosure and other investor overhauling prerequisites needed of listed companies\textsuperscript{308}.

4.6.3 Issue Mechanism

SEBI has attempted to address different parts of the issue process (pre and post issue). Narrative records demonstrate that as the controlled value administration of the CCI days gave windfall chances to investors, the distribution and post-issue techniques gave a fruitful ground to deceitful promoters and their issue management agencies to participate in practices that hurt investor interest. Thus, the gigantic levels of oversubscription gave chances to financiers to the issue and also promoters to revel in the membership monies, including those from provisions which completed not get offer portions. SEBI endeavored to attachment this

\textsuperscript{305} Ibid
\textsuperscript{306} SEBI [1996]: Securities and Exchange Board of India Annual Report for 2003-04
\textsuperscript{307} Ibid
\textsuperscript{308} Ibid
through the utilization of Stock contribute, an installment instrument by which the investor's requisitions monies might win enthusiasm for the investor work such time as the Stock contribute was liquidated -by the investor or the recorder to the issue against fruitful assignment. Throughout the years SEBI committed impressive administrative exertion and consideration regarding guarantee that investors who utilized the Stock contribute completed not accept a short of what equivalent medication from issuers and their operators contrasted with those investments who utilized exchange installment components that permitted issuers to delight in investor's application funds.

SEBI presented the proportionate portion handle because of the issue of different, frequently benami, application. Investors depended on these strategies to augment the shots of distribution particularly in profoundly oversubscribed issues. Issuers reacted to the proportionate portion prerequisite by constraining the greatest number of shares distributed to each one inquirer in order to acquire extensive amounts of shares getting amassed in the hands of a little aggregation of investors. Instinctively one can see that the proportionate distribution and the issuers' reaction thereto were a wellspring of business flaw.

SEBI mandated the association of a public representative in the allocation handle in all public issue portions to guarantee that the allocations were made in a reasonable way and as per the rules. This was apparently activated by the various examples of insufficiencies and irregularities in the apportioning process that was uncovered by SEBI's assessment of the Registrars to the Issue and Share Transfer Agents throughout 1992-93. SEBI traded the prerequisite of an open chosen one with the necessity of cohering SEBI's asset faculty and that the prerequisite of associating stock exchange work force in 1999-2000.

The other real region of center for SEBI throughout the years has been the issue system fundamentally. In. 1995-96, SEBI presented the first significant activity by affirming rules for book building public issues for issues bigger than Rs 100 crores, up to 75% of the net offer to the public. In. 1997-98, SEBI stretched out book building to 100% of the issue to permit the whole issue to appreciate the profit of value and interest disclosure. In. 1998-99 SEBI further stretched out the 100% book building to issue sizes of Rs 25 crores or more. At the same time the first book manufactured issues completed not enter the business sector work 1999-2000. Book built issues began picking sizably from 2000-01, the year in which

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309 Ibid
310 Ibid
SEBI withdrew the minimum issue necessity of Rs 25 crores and further reinforced and streamlined the book building courses of action\textsuperscript{312}.

4.6.4 Secondary Market

Trading and Trading Mechanism

The main screen based exchanging framework was set up by OTCEI in 1992. Notwithstanding screen based trading made an effect on the standard stock exchange with the setting up of the NSE in 1994. Around the same time, SEBI began swaying other stock exchange to up screen based exchanging frameworks. Mumbai, Pune and Delhi stock exchanges set up screen based exchanging frameworks, apparently at SEBI’s instances in 1995-96. While without a doubt SEBI needed to push weight on a few exchange that dithered to switch to screen based exchanging, for example, Jaipur, Magadh and Inter-Connected Stock Exchanges India Ltd., in 1998-99 the actuality remains that these trades represented little exchanging volumes and thus the effect of the strategy for exchanging on these trades might not have had any commonsense results\textsuperscript{313}.

At the same time whatever the part of or the need for regulation in realizing the move the profits of screen based exchanging at the real trades are noteworthy. As SEBI noted in its yearly report, "With the computerization of exchanging and post exchanging frameworks on the significant stock trades it has gotten to be more troublesome to control costs and to disguise review trails of such control". However mechanization of exchanging likewise in a general sense changed the trading and lending of the business of stock exchanges as the operations of NSE and The Stock Exchange, Mumbai were permitted to be stretched out electronically to different urban areas from 1996-97. SEBI permitted the two exchanges to set up exchanging terminals in different urban communities in after an empowering correction to the SCR Act was passed." The offer of the other stock exchanges in the aggregate national exchange on stock exchanges dropped consistently from 57% in 1994-95 to 4% in 2002-03. In the long run, in 1999-2000 these other stock exchanges were permitted by SEBI to from subsidaries through which their parts could exchange on BSE or NSE in order to give an interchange exchanging source to their parts\textsuperscript{314}.

\textsuperscript{312} Ibid
\textsuperscript{313} Ibid
\textsuperscript{314} Ibid
4.7 Regulatory Reforms and Framework for Venture Capital and Private Equity in India

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Major Regulatory Framework for Venture Capital and Private Equity in India

There have been enormous lawful and regulatory reforms in the Venture Capital and Private Equity sectors, which have prompted the current situation from when the boom in the Private Equity companies finishes the buy back in India. Some of the major reforms are the following:

- Government of India issued guidelines in September 1995 for overseas Venture Capital investment in India.
- SEBI framed SEBI (Venture Capital Funds) Regulations, 1996.
- In 1999-the Companies (Amendment) Act, 1999, shed former support of Central Government for investment by a company surpassing 60 percent (paid-up offer capital + free reserves) or 100 percent free reserves, whichever is more, and empowered the company to make contribution by method for uncommon determination at general meeting.
- In 2000-SEBI presented another regulation for SEBI (Foreign Venture Capital Investors) Regulations, 2000, empowering foreign Venture Capital and Private Equity investors to enroll with SEBI and benefit certain profits gave there under.

• In 2000-corrections were made in SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1997; thus, these regulations were not to apply to the shares exchanged from VCF or FVCI to the promoters or to the company itself, if effected according to previous agreements between VCF or FVCI and promoters of the company. In the event that promoters buy back the shares from FVCI, then there is no necessity of public offering.

• In 2000-according to FEMA, PVCI can get or offer any investment held by it at a commonly acceptable price.

• In 2001-The Companies (Amendment) Act, 2001, diminished the time of issue of new fresh shares.

• In 2001-The Companies (issue of offer capital with differential voting rights) Rules, 2001, permitted each company restricted by shares to issue offers with differential rights (voting or profit).

• In 2003-Qualified Institutional Buyer (QIB) status allowed to VCF/FVCF, according to SEBI (DIP) rules. VCF/FVCF can subscribe securities at IPQ of a VCU through book-building procedure.

• In 2004- VCF/FVCF allowed to put resources into NBFC enrolled with RBI and occupied with supplies renting or Hire Purchase. It allowed to put resources into companies occupied with gold financing for adornments. FVCI permitted to put 100 percent in one VCU, as contrasted with the 25 percent prior.

• 2005- -in the press note 1 of 2005, exception was conceded from earlier government approbation 18 of 1998.

• The Indian Trust Act, 1882 or the Company Act, 1956 depending on whether the fund is set up as a trust or a company.

• The Foreign Investment Promotion Board (FIPB) and the RBI in case of an offshore fund. These funds have to secure the permission of the FIPB while setting up in India and need a clearance from the RBI for any repatriation of income.

• The Central Board of Direct Taxation (CBDT) governs the issues pertaining to income tax on the proceeding from VC funding activity. The long term capital gain tax is at around 10% in India and the relevant clauses to VC may be found in Section 10(sub section 23)
• Overseas venture capital investments are subject to the Government of India Guidelines for Overseas Venture Capital Investment in India dated September 20, 1995.

• For tax exemptions purposes venture capital funds also need to comply with the Income Tax Rules made under Section 10(23FA) of the Income Tax Act.

• In addition to the above, offshore funds also require FIPB/RBI approval for investment in domestic funds as well as in Venture Capital Undertakings (VCU). Domestic funds with offshore contributions also require RBI approval for the pricing of securities to be purchased in VCU likewise, at the time of disinvestment, RBI approval is required for the pricing of the securities.

Definition of Venture Capital Fund: The Venture Capital Fund is now defined as a fund established in the form of a Trust, a company including a body corporate and registered with SEBI which:

i. Has a dedicated pool of capital;

ii. Raised in the manner specified under the regulations; and

iii. To invest in venture capital undertaking in accordance with the regulation.

Definition of Venture Capital Undertaking: Venture Capital Undertaking means a domestic company:

i. Whose share are not listed on a recognized stock exchange in India

ii. That is engaged in business including such activities or sectors which are specified in the negative list by the Board with the approval of the Central Government by notification in the Official Gazette in this behalf. The negative list includes real estate, non-banking financial services, gold financing, activities not permitted under the Industrial Policy of the Government of India.

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316 Ib.d
317 Section 2 (m) SEBI (Venture Capital Funds) Regulations, 1996
318 Section 2 (n) SEBI (Venture Capital Funds) Regulations, 1996
Minimum contribution and fund size: the minimum investment in a Venture Capital Fund from any investor will not be less than Rs.5 lacks and the minimum corpus of the fund before the fund can start activities shall be at least Rs.5 corers\(^{319}\).

Investment Criteria: The earlier investment criterion has been substituted by new investment criteria which has the following requirements\(^{320}\):

- Disclosure of investment strategy;
- Maximum investment in single venture capital undertaking not to exceed 25% of the corpus of the fund;
- Investment in the associated companies not permitted;
- At least 75% of the investible funds to be invested in unlisted equity shares or equity linked instruments;
- Not more than 25% of the investible funds may be invested by way of;
- Subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed subject to lack in period of one year;
- Debt or debt instrument of a venture capital undertaking in which the venture capital funds has already made an investment by way of equity.

It has also been provided that Venture Capital Fund seeking to avail benefit under the relevant provisions of the Income Tax Act will be required to divest from the investment within a period of one year from the listing of the Venture Capital Undertaking\(^{321}\).

Disclosure and Information to Investors: in order to simplify and expedite the process of fund raising, the requirement of filing the Placement memorandum with SEBI is dispensed with and instead the fund will be required to submit a copy of Placement Memorandum/ copy of contribution agreement entered to with the investors along with the details of the fund raiser for information to SEBI. Further, the contents of the Placement Memorandum are

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319 Inserted by the SEBI (Venture Capital Funds) (Amendment) Regulations, 2000, w.e.f. 15-09-2000.
320 Section 12 SEBI (Venture Capital Funds) Regulations, 1996
321 Ibid
strengthened to provide adequate disclosure and information to investors. SEBI will also prescribe suitable reporting requirement from the fund on their investment activity.

Qualified Institutional Buyer (QIB) status for Venture Capital funds: the venture capital funds will be eligible to participate in the IPO through book building route as qualified Institutional Buyer subject to compliance with the SEBI (Venture Capital Fund) (Amendments) Regulations 2000.

Relaxation in Takeover Code: the acquisition of share by the company or any of the promoters from the Venture Capital Funds under the terms of agreement shall be treated on the same footing as that of acquisition of shares by promoters/companies from the state level financial institutions and shall be exempt from making an open offer to other shareholders.

Investment by Mutual Funds in Venture capital Funds: in order to increase the resources for domestic venture capital funds, Mutual Funds are permitted to invest up to 5% of its corpus in the case of open ended schemes and up to 10% of its corpus in the case of close ended schemes. A part from raising the resources for Venture Capital Funds this would provide an opportunity to small investors to participate in venture capital activities through Mutual funds.

4.7 SEBI (Venture Capital Fund) Regulations, 1996

The existing set up of venture capital in India needs to be streamlined and strengthened. The entry of private sector should be encouraged. Tax exemptions and concessions should be given to the investors investing in risky ventures. Government should offer attractive opportunities to foreign investors to invest in venture capital firms. SEBI has been a regulatory body for venture capital companies or funds with effect from Jan. 25, 1995. The Guidelines are listed below:

Registration of Venture Capital Funds: The application for Grant of Certificate

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522 Section 12A SEBI (Venture Capital Funds) Regulations, 1996, Inserted by the SEBI (Venture Capital Funds) (Amendment) Regulations, 2000, w.e.f. 15-09-2000
523 Ibid
524 Ibid
525 Pandey I M. Venture Capital – The Indian Experience, p. 280, 1999
526 Ibid
527 Section 3 SEBI (Venture Capital Funds) Regulations, 1996
a. Any company or trust proposing to carry on any activity as a venture capital fund on or after the commencement of these regulations shall make an application to the Board for grant of a certificate.

b. Any company or trust, who on the date of commencement of these regulations is carrying any activity as a venture capital fund without a certificate shall make an application to the Board for grant of a certificate within a period of three months from the date of such commencement: Provided that the board, in special cases, may extend the said period up to a maximum of six months from the date of such commencement.

c. An application for grant of certificate under sub-regulation (1) or sub-regulation (2) shall be made to the Board in Form A and shall be accompanied by a non-refundable application fee of Rs. 25,000 by way of bank draft issued in favour of SEBI at Mumbai.

d. Any company or trust referred to in sub-regulation (2) who fails to make an application for grant of a certificate within the period specified therein shall cease to carry on any activity as a venture capital fund.

e. The Board may in the interest of the investors issue directions with regard to the transfer of records, documents or securities or disposal of investments relating to its activities as a venture capital fund.

f. The Board may in order to protect the interests of investors appoints any person to take charge of records, documents, securities and for this purpose also determine the terms and conditions of such an appointment.

Eligibility criteria: For the purpose of the grant of a certificate by the Board the applicant have to fulfill in particular the following conditions, namely:

a. If the application is made by a company:

   i. memorandum of association as has its main objective, the carrying on of the activity of a venture capital fund;
   ii. it is prohibited by its memorandum and articles of association from making an invitation to the public to subscribe to its securities;
   iii. its director or principal officer or employee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;

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328 Ibid
329 Section 4 SEBI (Venture Capital Funds) Regulations, 1996
iv. its director, principal officer or employee has not at any time been convicted of any offence involving moral turpitude or any economic offence;

v. it is a fit and proper person;

b. if the application is made by a trust

i. the instrument of trust is in the form of a deed and has been duly registered under the provisions of the

ii. Indian Registration Act. 1908 (16 of 1908);

iii. the main object of the trust is to carry on the activity of a venture capital fund;

iv. the directors of its trustee company, if any or any trustee is not involved in any litigation connected with the securities market which may have an adverse bearing on the business of the applicant;

v. the directors of its trustee company, if any, or a trustee has not at any time, been convicted of any offence involving moral turpitude or of any economic offence;

vi. the applicant is a fit and proper person;

c. the company or trust has not been refused a certificate by the Board or its certificate has been suspended or cancelled. Furnishing of information, clarification: The Board may require the applicant to furnish such further information as it may consider necessary.

Consideration of application: An application which is not complete in all respects shall be rejected by the Board: Provided that, before rejecting any such application, the applicant shall be given an opportunity to remove, within thirty days of the date of receipt of communication, the objections indicated by the Board: Provided further that the Board may, on being satisfied that it is necessary to extend the period specified in the first proviso, extend such period by such further time not exceeding ninety days.

Procedure for Grant of Certificate

a. If the Board is satisfied that the applicant is eligible for the grant of certificate, it shall send an intimation to the applicant.

b. On receipt of intimation, the applicant shall pay to the Board, the registration fee of Rs. 500,000 payable by way of bank draft in favor of SEBI at Mumbai.

\[^{330}\text{Ibid}\]
\[^{331}\text{Ibid}\]
c. The Board shall on receipt of the registration fee grant a certificate of registration in Form B\textsuperscript{332}.

\textit{Conditions of certificate:} The certificate granted shall be \textit{inter alia}, subject to the following conditions, namely-

a. the venture capital fund shall abide by the provisions of the Act, the Government of India Guidelines and these regulations;

b. the venture capital fund shall not carry on any other activity other than that of a venture capital fund;

c. the venture capital fund shall forthwith inform the Board in writing if any information or particulars previously submitted to the Board are found to be false or misleading in any material particular or if there is any change in the information already submitted\textsuperscript{333}.

\textit{Investment Conditions and Restrictions}

Minimum investment in a venture capital fund: A venture capital fund may raise monies from any investor whether Indian, foreign or non-resident Indian. No venture capital fund set up as a company or any scheme of a venture capital fund set up as a trust shall accept any investment from any investor which is less than five lakh rupees: Provided that nothing contained in sub-regulation shall apply to investors who are (a) employees or the principal officer or directors of the venture capital fund, or directors of the trustee company or trustees where the venture capital fund has been established as a trust; or (b) non-resident Indians; or (c) persons or institutions of foreign origin\textsuperscript{334}.

Restrictions on investment by a venture capital fund: All investments made or to be made by a venture capital fund shall be subject to the following restrictions:

a. the venture capital fund shall not invest in the equity shares of the company or institutions providing financial services;

b. at least 80 per cent of funds raised by a venture capital fund shall be invested in:

i. the equity shares or equity related securities issued by a company whose securities are not listed on any recognised stock exchange: Provided that a venture capital fund

\textsuperscript{332} Section 7 SEBI (Venture Capital Funds) Regulations, 1996

\textsuperscript{333} Section 8 SEBI (Venture Capital Funds) Regulations, 1996

\textsuperscript{334} Section 11 SEBI (Venture Capital Funds) Regulations, 1996
may invest in equity shares or equity related securities of a company whose securities are to be listed or are listed where the venture capital fund has made. These investments through private placements prior to the listing of the securities\(^\text{335}\); ii. the equity shares or equity related securities of a financially weak company or a sick industrial company, whose securities mayor may not be listed on any recognised stock exchange\(^\text{336}\).

Explanation-For the purposes of this regulation, a “financially weak company” means a company, which has at the end of the previous financial year accumulated losses, which has resulted in erosion of more than 50 % but less than 100 % of its net worth as at the beginning of the previous financial year\(^\text{337}\), iii. providing financial assistance in any other manner to companies in whose equity shares the venture capital fund has invested under sub-clause (i) or sub-clause (i), as the case may be\(^\text{338}\).

Explanation-For the purposes of this regulation, “funds raised” means the actual monies raised from investors for subscribing to the securities of the venture capital fund and includes monies raised from the author of the trust in case the venture capital fund has been established as a trust but shall not include the paid up capital of the trustee company, if any. Prohibition on listing - No venture capital fund shall be entitled to get its securities or units, as the case may be, listed on any recognised stock exchange till the expiry of three years from the date of the issuance of securities or units, as the case may be, by the venture capital fund\(^\text{339}\).

Prohibition on inviting subscription from the public:. No venture capital fund shall issue any document or advertisement inviting offers from the public for the subscription or purchase of any of its securities or units\(^\text{340}\).

Private placement A venture capital fund may receive monies for investment in the venture capital fund through private placement of its securities or units\(^\text{341}\).

\(^{335}\) Ibid
\(^{336}\) Ibid
\(^{337}\) Ibid
\(^{338}\) Ibid
\(^{339}\) Ibid
\(^{340}\) Section 14 SEBI (Venture Capital Funds) Regulations, 1996
\(^{341}\) Section 15 SEBI (Venture Capital Funds) Regulations, 1996

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4.8 SEBI (Foreign Venture Capital Investors) Regulations, 2000

The following will be the salient features of SEBI (foreign Venture Capital Investors) Regulations, 2000:

**Definition of Foreign Venture capital Investor:** any entity incorporated and established outside India and proposes to make investment in Venture Capital Fund or Venture Capital Undertaking and registered with SEBI\(^\text{342}\).

**Eligibility Criteria:** entity incorporated and established outside India in the form of Investment Company, Trust, Partnership, Pension Fund, Mutual Fund, University Fund, Endowment Fund, Asset Management Company, Investment Manager, Investment Management Company or other Investment Vehicle Incorporated outside India would be eligible for seeking registration from SEBI. SEBI for the purpose of registration shall consider whether the applicant is regulated by an appropriate foreign regulatory authority; or is income tax payer; or submits a certificate from its banker of its or its promoters track record where the applicant is neither a regulated entity nor an income tax payer\(^\text{343}\).

**Investment Criteria:**

a. Disclosure of investment strategy;

b. Maximum investment in single venture capital undertaking not to exceed 25% of the funds committed for investment to India however it can invest its total fund committed in one venture capital fund;

c. At least 75% of the investible funds to be invested in unlisted equity shares or equity linked instruments.

d. Not more than 25% of the investible funds may be invested by way of:

i. Subscription to initial offer of a venture capital undertaking whose shares are proposed to be listed subject to lock in period of one year;

ii. Debt or debt instrument of a venture capital undertaking in which the venture capital funds has already made an investment by way of equity\(^\text{344}\).

\(^{342}\) Section 2 (g) SEBI (Foreign Venture Capital) Regulations, 2000

\(^{343}\) Section 4 SEBI (Foreign Venture Capital) Regulations, 2000

\(^{344}\) Section 11 SEBI (Foreign Venture Capital) Regulations, 2000
Hassle Free Entry and Exit: the Foreign Venture Capital Investors proposing to make venture capital investment under the Regulations would be granted registration by SEBI. SEBI Registered Foreign Venture Capital Investors shall be permitted to make investment on an automatic route within the overall sectoral ceiling of foreign investment under Annexure III of statement of Industrial Policy without any approval from FIPB. Further, SEBI registered FVCIs shall be granted a general permission from the exchange control angle for inflow and outflow of funds and no prior approval of RBI would be required for pricing, however, there would be export reporting requirement for the amount transacted.345

Trading in Unlisted Equity: The board’s approval is required for the granting of permission to OTCEI to develop a trading window for unlisted securities where Qualified Institutional Buyers (QIB) would be permitted to participate.346

4.9 Regulations of the Business of Venture Capital Funds in India

Eligibility conditions for grant of license to a venture capital fund.-

(1) A venture capital fund shall not be granted license unless it fulfils the following conditions, namely:-

a) It is incorporated as a company under the Companies Ordinance, 1984 (XLVII of 1984);

b) It is not engaged in any business other than that of investment in venture projects;

c) It has a minimum paid-up capital of fifty million rupees raised through private placement; and

d) For the purpose of managing its entire business, it has entered into a contract, in writing, with a venture capital company and a copy of which has been filed with the Commission.

(2) The board of venture capital fund shall not have a director, who is on the board of any venture project being financed by the fund.347

345 Ibid
346 Ibid
347 Verma J.C., Manual of Merchant Banking, p. 146-152, 1994

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Condition for grant of license-

(1) No venture capital fund shall commence business unless a license is granted under these rules.

(2) For obtaining a license a venture capital fund shall:

   a. Make an application to the Commission on Form V providing information as sought in Annex therein, along with all the relevant documents;
   b. Submit a bank draft payable to the Commission evidencing the payment of non-refundable application processing fee amounting to fifty thousand rupees;
   c. Submit an undertaking that no change in the memorandum and articles of association and in the directors shall be made without prior written authorization of the Commission and that all conditions for grant of license shall be complied with 348.

(3) On being satisfied that a venture capital fund is eligible for the grant of a license and that it would be in the public interest so to do, the Commission may grant a license in form VI.

(4) Without prejudice to any other conditions under these rules, the Commission may while granting license imposes any conditions, as it may deem necessary 349.

Terms and conditions of operation-Unless granted a general or specific waiver by the Commission, a venture capital fund shall:

   a. Not expose more than forty per cent of its equity to any single group of companies; Explanation. - For the purposes of this rule group of companies shall mean companies managed by the members of one family including spouse, dependent lineal ascendants and descendants and dependent brothers and sisters.
   b. Disclose in its accounts all investments in companies and group of companies exceeding ten per cent of paid-up capital of venture capital fund;

348 Ibid
349 Ibid
c. ensure that the maximum exposure of the venture capital fund to its directors, affiliated companies and companies in which any of the directors and their family members including spouse, dependent lineal ascendants and descendants and dependent brothers and sisters hold controlling interest shall not exceed ten per cent of the overall portfolio of venture capital; and

d. Not accept any investment from any investor, which is less than one million rupees.

Renewal of license:

(1) The license granted to the fund under rule 10 shall be valid for one year and shall be renewable annually on payment of a fee of twenty thousand rupees on an application being made on Form VII.

(2) The Commission may, after making such inquiry and after obtaining such further information as it may consider necessary, renew the license of such fund, one year on Form VIII on such conditions as it may deem necessary.

Private placement:

A venture capital fund shall raise and receive monies for investment in venture projects through private placement of such securities as may be notified by the Commission, from time to time.

Placement memorandum:

A venture capital fund shall, before soliciting placement of its securities, file with the Commission a placement memorandum which shall inter alia give details of the terms subject to which monies are proposed to be raised from such placements.

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350 Ibid
351 Ibid
352 Ibid
353 Ibid

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4.9.1 Investment by Venture Capital Funds Outside India

SEBI registered Venture Capital Fund are permitted to invest in securities of foreign companies in terms of regulation 12(b) of the SEBI (Venture Capital Funds) Regulations 1996. Reserve Bank of India (RBI) vide its Circulars dated April 30, 2007 and May 4, 2007, issued in this regard, has permitted VCF to invest in equity and equity linked instruments only of off-shore Venture Capital undertakings, subject to overall limit of USD 500 million and applicable SEBI regulations. Investment would be made only in those companies which have an Indian connection (i.e. company which has a front office overseas, while back office operations are in India) and such investments would be up to 10 percent of the investible funds of a VCF.354

4.9.2 Policy on Foreign Direct Investment in VCF in India

Off shore Venture Capital funds/ companies are allowed to invest in domestic Venture Capital undertaking as well as other companies through the automatic routes, subject only to SEBI regulations and sector specific caps on Foreign Direct Investment.355

4.9.3 Investment Conditions and Restrictions on VCF and FVCI

a) A VCF may raise money from any investor, whether Indian, Foreign or Non-resident Indian, by way of issue of units.

b) No VCF shall accept any investment from any investor which is less than 5 lacs, except from employees/ principal officer/directors/trustee of the VCF or the employees of the fund manager or Asset Management Company.

c) VCF shall have firm commitment of at least 5 crore from the investors before the start of operations by the VCF.

d) VCF/FVCI shall disclose investment strategy to SEBI before registration.

e) VCF shall not invest more than 25 percent of the funds in one VCU. FVCI can invest its total funds in one VCU.

f) VCF shall not invest in associated companies.

g) VCF/FVCI shall disclose duration of the life cycle of the fund to SEBI.

h) At least 66.67 percent of the investible funds shall be invested in unlisted equity shares or equity linked instruments of VCU.

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354 Section 12(b) SEBI (Venture Capital Funds) Regulations 1996.
355 Ibid
i) Not more than 33.33 percent of the investible funds may be invested by way of:
   a. Subscription to IPO of a VCU whose shares are proposed to be listed.
   b. Debt or debt instrument of a VCU in which VCF/FVCI has already made
      an investment by way of equity.
   c. Preferential allotment of equity shares of a listed company subject to lock-
      in period of one year.
   d. The equity shares or equity linked instruments of a financially weak
      company or a sick industrial company whose shares are listed.
   e. Special Purpose Vehicle which are created by VCF for the purpose of
      facilitating or promoting investment\textsuperscript{356}.

4.9.4 Registration Benefits to Foreign Venture Capital with SEBI

The law does not make it mandatory for Foreign Venture Capital and Private Equity
Funds to get themselves registered with SEBI. They can invest in India as per Foreign Direct
Investment policy without getting registered with SEBI. They can also invest in India by
getting registered with SEBI as Foreign Venture Capital Investor. By registering with SEBI
as FVCI, Foreign Venture Capital and Private Equity funds can avail following benefits:
   a. Exemption from usual share valuation practice. It could be a negotiated price.
   b. SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, do not
      apply to the shares transferred from FVC) to the promoters or to the company
      itself, if effected as per pre-existing agreement between FVCI and promoters of
      the company. If promoters buy back the shares from FVCI, then there will be no
      requirement of public offering.
   c. The Venture Capital funds will be eligible to participate in the Initial Public
      Offering through book building route as Qualified Institutional Buyer subject to
      compliance with the SEBI (Venture Capital Fund) Regulations 1996.
   d. Tax pass through status for investment in nine sectors under Income Tax Act,
      1961.

\textsuperscript{356} Ibid
e. Exemption from taking prior approval from government in case a foreign investor has an existing joint venture or technology transfer/trademark agreement in the same field.\(^{357}\)

4.10 Foreign Exchange Management (Transfer of Issue of Security by a Person Resident Outside India) Regulations, 2000

The FEMA Regulations prescribe the manner in which a foreign venture capital investor can make investments.\(^{358}\) A foreign venture capital investor, can through SEBI, apply to the Reserve Bank of India (RBI) for permission to invest in an Indian venture capital undertaking, a venture capital fund or in a scheme floated by a venture capital fund. The consideration amount for investment can be paid out of inward remittances from abroad through normal banking channels. Subject to RBI approval, a foreign venture capital investor can maintain a foreign currency or rupee account with an authorized Indian bank. The funds held in such accounts can be used for investment purposes.\(^{359}\)

The FEMA Regulations prescribe the sectoral limits on foreign investments into India. A company, which is inter alia engaged in the print media sector, atomic energy and related projects, broadcasting, postal services, defence and agricultural activities, must obtain the approval of the Foreign Investment Promotion Board or Secretariat of Industrial Assistance, depending on the quantum of investment, before issuing shares to a foreign venture capital investor situated abroad.\(^{360}\)

4.11 Income-Tax Act, 1961

The income of venture capital companies or funds set up to raise funds for investment in venture capital undertakings is tax exempt, if they are registered with SEBI and in compliance with Indian government and SEBI Regulations. The income of such companies and/or funds will continue to be exempt, if the undertaking, in which its funds are invested, subsequent to the investment, gets listed on a stock exchange. However, tax will be payable by the shareholders of or withdrawers from the company or fund. Venture capital companies or funds are exempt from withholding tax in respect of income distributed to their investors.

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\(^{357}\) Ibid  
\(^{358}\) Section 2 Foreign Exchange Management (Transfer of Issue of Security by a Person Resident Outside India) Regulations, 2000  
\(^{359}\) Ibid  
The provisions of the IT Act regarding taxation on distributed profits (dividend), distributed income and deduction of tax at source do not apply to venture capital companies or funds.\textsuperscript{363}

**4.12 Alternative Investment Fund Regulations 2012**

The Securities and Exchange Board of India issued the SEBI (Alternative Investment Fund) Regulations, 2012 which repealed the SEBI (Venture Capital Fund) Regulations, 1996. By the AIF Regulations, SEBI intends to regulate all privately pooled investment vehicles.\textsuperscript{362}

The VCF Regulations was the sole regulation that regulated such private pooling vehicles. However, the VCF Regulations did not mandate such vehicles to be registered with SEBI and registration was made optional. This led to several private equity funds being floated, without having to comply with any investment restrictions prescribed under the VCF Regulations. True that registration with SEBI under VCF Regulations came with certain merits, but flexibility in operation of a fund seemed to have an edge and fund houses also choose a less merited unregulated fund over a merited regulated fund.\textsuperscript{363}

Further, the intention behind VCF Regulations was to promote investments into start-ups and mid-size companies. However, most VCFs made operated as real estate funds, infrastructure funds, etc. Thus, a need was felt to frame a more exhaustive set of regulations to govern all such kinds of private funds, viz. venture capital funds, real estate funds, social ventures funds, SME funds, etc. and also open up market for more complex structures such as hedge funds. Accordingly, SEBI notified the AIF Regulations to govern unregulated entities and create a level playing ground for existing venture capital investors.\textsuperscript{364}

**Implication of AIF Regulations on venture capital funds**

As stated above, the VCF Regulations did not require venture capital funds to be registered with SEBI. The AIF Regulations required the unregistered VCFs which qualify as an AIF shall register with SEBI under an appropriate category of AIF within 6 months from the date of operation. These funds were permitted to raise capital up to an amount of commitment received by them as on date of registration as AIF. So far as the registered VCFs are concerned, they shall continue to be regulated by the VCF Regulations until the existing VCF or scheme is wound up. No new scheme shall be launched by the VCFs and no the

\textsuperscript{361} Income Tax Act 1961
\textsuperscript{362} Ibid
\textsuperscript{364} Ibid

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targeted corpus size shall not be increased. A VCF is permitted to seek registration as an AIF upon intention of approval of two-thirds of their investors by value of their investment\(^{365}\).

**Definition an AIF:** The AIF Regulations defines an AIF as following\(^ {366}\):

(a) A fund established in India either as a trust, company, limited liability partnership ("LLP") or a body corporate;

(b) A privately pooled investment vehicle that collects money from investors for investment in accordance with a defined investment policy;

(c) All investments are made for the benefit of the investors;

(d) The investors may be Indian or foreign (subject to the extant foreign direct investment policy of India);

(e) A fund which is not covered under the SEBI (Mutual Funds) Regulations, 1996, Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999 or any other SEBI regulations to regulate fund management activities

(f) Does not comprise any of the following:

(i) Family trusts;

(ii) ESOP trusts;

(iii) Employee welfare trusts or gratuity trusts;

(iv) Holding Companies;

(v) other special purpose vehicles not established by fund managers, including securitization trusts, regulated under a specific regulatory framework;

(vi) funds managed by securitization company or reconstruction company which is registered with the Reserve Bank of India; and

(vii) any such pool of funds which is directly regulated by any other regulator in India\(^ {367}\).

Venture Capital Funds means an Alternative Investment Fund which invests primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings mainly

\(^{365}\) Ibid
\(^{366}\) Section 2 (b) SEBI (Alternative Investment Funds) Act 2012
\(^{367}\) Ibid
involved in new products, new services, technology or intellectual property right based activities or a new business model\(^{368}\); Venture Capital Undertaking means a domestic company:

(i) which is not listed on a recognised stock exchange in India at the time of making investment; and 

(ii) which is engaged in the business for providing services, production or manufacture of article or things and does not include following activities or sectors:

- non-banking financial companies;
- gold financing;
- activities not permitted under industrial policy of Government of India;
- any other activity which may be specified by the Board in consultation with Government of India from time to time\(^{369}\);

**Forms in which AIF may be constituted**

The AIF Regulations permit setting up of an AIF either as a trust, a company, an LLP or a body corporate. However, for many reasons, primarily being the operational flexibility, taxation benefits and practically no compliances, trust has been a consistent practice and a unanimous choice in India for establishing an AIF\(^{370}\).

Alternative Investment Funds shall seek registration in one of the categories mentioned hereunder and in case of Category I Alternative Investment Fund, in one of the sub-categories thereof\(^{371}\):

(a) Category I Alternative Investment Fund which invests in start-up or early stage ventures or social ventures or SME or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable and shall include venture capital funds, SME Funds, social venture funds, infrastructure funds and such other Alternative Investment Funds as may be specified\(^{372}\);

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\(^{368}\) Sec 2 (z) SEBI (Alternative Investment Funds) Act 2012

\(^{369}\) Sec 2 (aa) SEBI (Alternative Investment Funds) Act 2012

\(^{370}\) Sec 3 (4) SEBI (Alternative Investment Funds) Act 2012

\(^{371}\) Sec 16 SEBI (Alternative Investment Funds) Act 2012

\(^{372}\) Ibid
Explanation.— For the purpose of this clause, Alternative Investment Funds which are generally perceived to have positive spill over effects on economy and for which the Board or Government of India or other regulators in India might consider providing incentives or concessions shall be included and such funds which are formed as trusts or companies shall be construed as —venture capital company or —venture capital fund as specified under sub-section (23FB) of Section 10 of the Income Tax Act, 1961.

(b) Category II Alternative Investment Fund which does not fall in Category I and III and which does not undertake leverage or borrowing other than to meet day-to-day operational requirements and as permitted in these regulations.

Explanation.— For the purpose of this clause, Alternative Investment Funds such as private equity funds or debt funds for which no specific incentives or concessions are given by the government or any other Regulator shall be included.

(c) Category III Alternative Investment Fund which employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives.

Explanation.— For the purpose of this clause, Alternative Investment Funds such as hedge funds or funds which trade with a view to make short term returns or such other funds which are open ended and for which no specific incentives or concessions are given by the government or any other Regulator shall be included.

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 AIF378.

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, is necessary379.

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 at least 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 investors380.

Main Conditions:

a) The minimum size of the AIF has to be Rs. 20 crores.

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 Rs.1 crore.

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.

378 Sec 4 SEBI (Alternative Investment Funds) Act 2012  
379 Sec 5 SEBI (Alternative Investment Funds) Act 2012  
380 Sec 10 SEBI (Alternative Investment Funds) Act 2012
f) AIF can solicit investment by investors only through private placement by issuance of information memorandum\textsuperscript{381}.

**Term of the Fund**

a) All AIF are required to be close ended and the duration of fund shall be determined at the time of registration.

b) The tenure of the funds shall be minimum for a period of 5 years.

c) Extension of the tenure of the fund may be permitted up to 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\textsuperscript{382}.

**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\textsuperscript{383}.

**Main Investment Conditions Specified for Each Category of AIF**

**Venture Capital Fund**

\textsuperscript{381} Ibid
\textsuperscript{382} Ibid
\textsuperscript{383} Sec 15 SEBI (Alternative Investment Funds) Act 2012
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 up to 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.384

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.385

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384 Sec 16 SEBI (Alternative Investment Funds) Act 2012
385 Ibid
**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\(^{386}\).

**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 up to 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\(^{387}\).

**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 SPV of infrastructure projects as defined by Central Government or Planning Commission.

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\(^{386}\) Sec 17 SEBI (Alternative Investment Funds) Act 2012  
\(^{387}\) Sec 18 SEBI (Alternative Investment Funds) Act 2012
b) Permitted to invest up to 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\(^{388}\).

**Small and Medium Enterprise (SME) Fund**

a) The SME fund can invest primarily in the unlisted equity or equity linked instruments of SME in manufacturing, services sector as also businesses providing infrastructure or other support to SME 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\(^{389}\).

**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 up to 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 up to 33.33% of its corpus in debt or debt instruments of real estate projects or special purpose vehicles engaged in real estate projects\(^{390}\).

**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 which satisfy social performance norms laid down by the fund\(^{391}\).

\(^{388}\) Ibid
\(^{389}\) Ibid
\(^{390}\) Ibid
\(^{391}\) Ibid
**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.\(^{392}\)

**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. AIF such as PIPE funds or SME funds or VCF would be considered as QIB for the purpose of QIP under the ICDR Regulations.

3. Investments in NBFC 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 AIF (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 VCF.\(^{393}\)

**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 Rs. 500 crores 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.\(^{394}\)

\(^{392}\) Ibid

\(^{393}\) Ibid

\(^{394}\) Sec 19 SEBI (Alternative Investment Funds) Act 2012
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.\(^{395}\)

\(^{395}\) Ibid