

The Securities and Exchange Board of India (**SEBI**) approved amendments to certain key regulations in its board meeting held on 23 November 2016. These amendments have been proposed to relax investment norms and develop the start-up environment in India. This update provides a snapshot of these proposed amendments and briefly examines the implications of these amendments.

- The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (**Listing Regulations**) are proposed to be amended to address potential corporate governance issues arising out of compensation agreements of promoters, directors and key managerial personnel of listed companies.
- In line with ongoing measures to encourage start-ups in India, and to develop the market for alternative investments, SEBI has approved amendments to the SEBI (Alternative Investment Funds) Regulations, 2012 (**AIF Regulations**).
- To enhance the investor base for unlisted debt securities and securitized debt instruments, amendments to the SEBI (Foreign Portfolio Investors) Regulations, 2014 (**FPI Regulations**) are proposed.

Listing Regulations – Additional Disclosure Requirements

SEBI has in the recent past raised concerns on compensation agreements entered into by promoters, directors, key managerial personnel and employees of listed companies with private equity investors without the knowledge of shareholders. To this end, SEBI had released a [Consultation Paper](#) and invited public comments. SEBI's concern was that officers of listed companies could potentially be incentivized through profit-sharing based compensation arrangements by private equity funds, and no longer be guided by fiduciary obligations owed to the company. To ensure transparency and promote robust compliance with respect to such compensation agreements, the Listing Regulations are to be amended to reflect the following:

- Promoters, directors, key managerial personnel and other employees of listed entities may only enter into any agreement regarding compensation or profit-sharing with any shareholder or any other third party following approval from SEBI as well as public shareholders.
- Listed companies, where such agreements have been entered into over the last three years, must disclose these arrangements to the stock exchanges for public dissemination.
- Existing agreements entered into previously (which continue to be valid) shall also be disclosed to the stock exchanges and approval shall be obtained from public shareholders by simple majority in the upcoming shareholders' meetings.

- Interested persons involved in the transactions shall abstain from voting on such resolutions.

While these additional disclosures will certainly ensure transparency and enable distribution of information to public shareholders with regard to the ongoing affairs of the company, seeking approval from SEBI for such compensation agreements (which approval may not always be forthcoming) may not be effective as it will give rise to another procedural hurdle which may divert the focus of management away from the company's daily operations.

AIF Regulations – Investment Restrictions Relaxed

SEBI had set-up the "Alternative Investment Policy Advisory Committee" (**AIPAC**) consisting of experts across market participants in 2015 to develop the alternative investment industry and boost the start-up environment. The AIPAC put forward certain recommendations to SEBI in order to relax the investment restrictions imposed on angel funds under the AIF Regulations. The AIF Regulations regulate privately pooled investment vehicles in India. Angel funds are funds permitted to raise funds only from angel investors and are registered as "Category I" alternative investment funds under the AIF Regulations. Angel funds accordingly have to comply with certain investment restrictions specified in the AIF Regulations.

SEBI in its board meeting discussed and approved the following recommendations:

- Threshold for classification as a "start-up" increased from three to five years, i.e., for the purposes of receiving angel investment, an Indian company will be considered a 'start-up' if it has not completed five years from the date of incorporation.
- Maximum number of angel investors in a registered fund increased from 49 to 200.
- Minimum investment amount required to be injected by an angel fund into a start-up halved from INR 5 million to INR 2.5 million.
- Lock-in for angel investors reduced from three years to one year.
- Angel funds will now be allowed to invest up to 25% of their investible capital in overseas venture capital undertakings.

Increasing the number of angel investors in a registered fund from 49 to 200 will allow angel funds to increase their investor base. Reduction in the minimum investment amount will allow angel funds the flexibility to diversify their investment portfolio. Easing of lock-in requirements will allow angel investors to exit their investments earlier and free capital to invest in other start-ups.

The increase in time period for classification of companies as 'start-ups' from three to five years aligns it with the definition of a "start-up" under the "Start-up India" initiative of the Department of Industrial Policy and Promotion, the authority responsible for regulating foreign investment limits and conditions in India.

FPI Regulations – Permitted Investments

Currently, Foreign Portfolio Investors (**FPIs**) are only permitted to invest in certain types of debt securities, such as non-convertible debentures of listed or to-be listed companies, or unlisted companies engaged in the infrastructure sector. SEBI approved an amendment to the FPI Regulations to permit investments by FPIs in non-convertible debentures of unlisted companies, as well as in securitized debt, subject to the following conditions:

- FPIs are permitted to invest in unlisted corporate debt securities issued by an Indian company subject to the guidelines issued by the Ministry of Corporate Affairs from time to time.
- FPIs are permitted to invest in securitised debt instruments, including any certificate or instrument issued by a special purpose vehicle set up for securitisation of assets with banks and financial institutions being originators; or issued and listed in terms of the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.
- The above investments by FPIs shall not exceed INR 350 billion.
- Investments by FPIs in unlisted corporate debt securities shall be subject to minimum residual maturity of three years and be subject to certain end-use restrictions (such as investment in real estate, capital market and purchase of land).

These amendments will help enhance the investor base in unlisted debt securities and securitised debt instruments. It will also develop the corporate bond and debenture markets in India. Private companies would have access to funds in the form of debt rather than having to dilute equity stake.

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