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Capital Markets Newsflash dated 5th August, 2008

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» RBI wants VC Investment Restricted to Select Sectors

Source: Economic Times
Date: August 5, 2008

NEW DELHI: Reserve Bank of India (RBI) has asked the Union finance ministry to prevent foreign investors from side-stepping foreign investment norms by taking recourse to the venture capital (VC) route.

With increasing concerns of foreign capital driving up real estate prices, RBI has recommended that foreign venture capital investments (FVCIs) be restricted to nine sectors (investment in other sectors being treated as foreign direct investment). It has suggested that capital market regulator SEBI set up a screening mechanism for all pending and future FVCI proposals.

The new set of restrictions will help prevent low capital base, circumvention of takeover guidelines and round-tripping of investments. Out of 58 FVCI Application pending with RBI, 22 are considered to have low capital base.

Foreign investment in the form of venture capital is accorded special concessions not available to normal foreign direct investment (FDI).

These include exemption from entry and exit pricing norms that otherwise apply to foreign investors; exemeption from the SEBI Takeover code for sale of shares by FVCIs to company insiders after listing; exemption from the one-year lock-in period for sale after an initial public offering (IPO) of shares purchased prior to the IPO; and exemption from sectoral FDI caps for investments in domestic venture capital funds.

RBI has written to the finance ministry seeking restriction of VC benefits only to those sectors that Union Budget 2007-08 identified as eligible for the benefit of tax pass-through: biotech, IT, nanotechnology, seed research, R&D to create new chemical entities in pharma, dairying, poultry, biofuels and hotel-cum-convention centres with more than 3,000 seats.

It is understood that the apex bank’s demand for regulating investment flow through the FVCI route stems from the quest to curb foreign funds flooding the real estate sector and creating a realty bubble.

The central bank feels that the current policy framework provides for regulatory arbitrage. Therefore, it has suggested that generalised concessions for FVCI across sectors should be done away with, and the concessions restricted to a positive list of sectors.

"SEBI may amend the FVCI regulations, restricting the eligible investment under the route, both in domestic venture capital funds as well as a domestic venture capital undertaking, only to a positive list of certain important sectors," says the RBI letter to the finance ministry. The sectors suggested are areas like biotech, IT which have been identified in the 2007 Budget for income tax benefits.

The FVCI route was accorded preferential status presumably in view of the need for an affirmative policy action to encourage development of entrepreneurial capabilities in high-risk, technology-intensive ventures and in greenfield projects.

RBI has noted that this route of investment has become a misnomer, since it allows for direct/indirect investment in all sectors, including real estate. The central bank feels that the FVCI route has opened up a parallel channel for investment, besides the FDI route and presents a classic case of regulatory arbitrage.

The present process of registration of FVCIs involves obtaining a no-objection certificate from SEBI, followed by permission from RBI under the Foreign Exchange Management Act. Mots funds using this route are based in Mauritius, Singapore and Cyprus.

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