

**Dolly Goklaney**

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**Subject:** FW: IVCA representation: Clarification on certain aspects of the SEBI VCF Regulations<sup>1</sup>

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Subject: IVCA representation: Clarification on certain aspects of the 'SEBI VCF Regulations'



C-7, Pashchimi Marg, Vasant Vihar, New Delhi - 110 057.

November 10, 2010

Mr Prashant Saran  
Whole Time Member  
Securities and Exchange Board of India  
Exchange Plaza, "G" Block, 4th Floor  
Bandra Kurla Complex, Bandra (E)  
Mumbai- 400 051

Dear Sir,

**Sub: Clarification on certain aspects of the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 ('SEBI VCF Regulations')**

We would like to bring to your attention a regulatory constraint faced by Venture Capital Funds ('VCFs') seeking to invest in companies operating in non-banking financial services ('NBFS') sector in India. This aspect has been discussed in detail in the ensuing paragraphs in the following manner:

Paragraph 1: Background

Paragraph 2: Regulatory aspects

Paragraph 3: Specific clarification sought

## 1. Background

- 1.1 Venture capital funding, by its very nature, entails high-risk, high-return types of investment.
- 1.2 Venture capitalists finance innovation and ideas which have potential for high growth, but with it, inherent uncertainties.
- 1.3 Hence, venture capital funding is required in every sector of the economy and should not be restricted from a sector such as NBFS.

## 2. Regulatory aspects

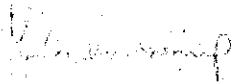
- 2.1 Under the SEBI VCF Regulations, a VCF is restricted from investing in companies engaged in rendering, *inter alia*, 'Non-banking financial services'<sup>(1)</sup>.
- 2.2 The term 'Non-banking financial services' has not been defined in the Regulations, but it would cover within its ambit industries such as insurance, broking, merchant banking, leasing and finance, investment advisory, etc.
- 2.3 Hence, by virtue of the SEBI VCF Regulations, venture funding is barred from sectors such as insurance, broking, etc; which otherwise would benefit from having access to venture capitalists.
- 2.4 There does not seem to be any rationale in prohibited venture capital investment in the NBFS sector; since this sector is highly regulated and entails a high degree of reporting to multiple regulatory authorities in India.
- 2.5 Further, SEBI (Foreign Venture Capital) Regulations, 1995 also prohibit an FVCI from making investment in companies engaged in rendering, *inter alia*, 'Non-banking financial services'. However, a foreign investor, desirous of making investment in companies engaged in rendering NBFS in India, can freely do so under the foreign direct investment route, subject to investment caps and other conditions as specified therein.
- 2.6 This results in an unwarranted preferential treatment being accorded to foreign investors. Hence, while foreign funds can invest in NBFS sector under the FDI route, such alternative route is not available to domestic funds.
- 2.7 VCF is the only avenue available for domestic pooling vehicles for investing in India. By restricting VCFs from investing in NBFS sector, domestic funds are blocked from accessing the NBFS sector, while foreign funds are at liberty to do so.
- 2.8 Venture capital funding plays an important role in filling the gap between the capital requirements of start-up enterprises and funding available to these from traditional institutional lenders. In this scenario, it is only justified to create a level playing field between VCFs and other foreign investors in terms of permissible investments as aforesaid. Further, the NBFS sector would stand to benefit a great deal, from the innovation, management insights and technology edge that VCFs would provide, besides funding.

## 3. Request for clarification

Given the above, we would sincerely appreciate if the item "Non-banking financial services" is removed from the negative list specified in the Third Schedule to the SEBI VCF Regulations.

PricewaterhouseCoopers Private Limited ('PwC') is assisting us on this matter. We would like to seek an appointment to come and discuss this further with you. Please let us know when it would be convenient for you.

Yours sincerely,



Mahendra Swarup  
President IVCA

Copy to : Mr. Ananta Barua, Executive Director, SEBI.

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<sup>(1)</sup> As per the negative list specified in the Third Schedule to SEBI VCF Regulations.