



C-7, Pashchimi Marg, Vasant Vihar, New Delhi - 110057

To

**The Insurance Regulatory and Development Authority**

ParisharamBhavan, 3<sup>rd</sup> Floor,

BasheerBagh, Hyderabad – 500 004,

Andhra Pradesh, India

**Attn: Mr Radhakrishnan Nair**

Ref: IRDA/F&I/INV/CIR/054/03/2012

2 July, 2013

Dear Sir

**Sub: Permission of Insurers to Invest in Category II Alternative Investment Funds**

We write with reference to the letter issued by the Insurance Regulatory and Development Authority (the “IRDA”) to the chief executive officers of all insurers (“Insurers”) dated 18 March 2013 (Ref:IRDA/F&I/INV/CIR/054/03/2013) with the subject ‘Permission of Insurers to invest in Category I Alternative Investment Funds’ (the “2013Letter”). We understand that the 2013 Letter was issued pursuant to the Securities and Exchange Board of India (“SEBI”) legislating the SEBI (Alternative Investment Funds) Regulations, 2012 (the “AIF Regulations”), and the AIF Regulations coming into force and effectively replacing the erstwhile SEBI (Venture Capital Funds) Regulations, 1996 (the “VCF Regulations”). The 2013 Letter provides Insurers permission to invest in Category I Alternative Investment Funds (“AIFs”) as understood under the AIF Regulations (“Category I Funds”), insofar as such funds are Infrastructure Funds or SME Funds as defined under the AIF Regulations.

[World over, Insurers and pension funds have been the biggest contributors to AIFs and other pools of development and growth capital.] In the Indian context, domestic AIF capital pools are in their infancy, as the total amount of capital raised in domestic Private Equity (“PE”)/Venture Capital (“VC”) funds is less than [US\$ 1 billion]



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against a total deployment of nearly [US\$ 50 billion] by the global PE/VC industry.

We understand that under the provisions of Section 27A(2) and Section 27B(3) of the Insurance Act, 1938 read with Regulations 3, 4 and 5 of the Insurance and Development Authority (Investment) Regulations, 2000 (the “**IRDA Regulations**”) as amended and clarified by the Insurance and Development Authority (Investment) (Fifth Amendment) Regulations, 2013 (the “**IRDA Investment Amendments**”), Insurers are permitted to invest in ‘other investments’ to the extent of 15% (Fifteen Percent) of their ‘Investment Assets’, as defined under Regulation 2(g) of the IRDA Investment Regulations.

Under the letter issued by the IRDA to the chief executive officers of Insurers dated 30 August 2011 (Ref: IRDA/F&I/CIR/INV/203/2011) with the subject ‘Investment in Venture Funds – Clarification’ (the “**2011 Letter**”), the IRDA specifically clarified that Insurers would be permitted to invest in ‘any Venture Fund registered under SEBI Regulations which include Venture Funds investing in Micro, Small and Medium Enterprises also’, subject to the relevant exposure norms.

Venture capital funds (“**Venture Capital Funds**”), as understood under the erstwhile VCF Regulations, were permitted to invest, in accordance with the VCF Regulations, in any domestic company (“**VCU**”) (i) whose shares are not listed on a recognised stock exchange in India; and (ii) which is not engaged in any ‘negative list’ sector.

The AIF Regulations include Category I (“**Category I Funds**”), Category II (“**Category II Funds**”) and Category III (“**Category III Funds**”) AIFs. Like Category I Funds, Category II Funds are to largely invest in unlisted investee companies and can additionally invest in units of Category I Funds and other Category II Funds. The investments made by Category II Funds will also serve to provide the risk and development capital that is sorely needed in the Indian market. Category III Funds include funds which invest in the ‘securities of listed or unlisted investee companies or derivatives or complex or structured products’ and may also invest in units of Category I Funds and Category II Funds. Category III Funds (unlike Category I Funds and Category II Funds) are also permitted to leverage in the course of making investments and may be considered as Hedge Funds. Globally, investment in AIFs covering fixed income, debt, convertibles and equities (like Category II Funds) are a proven class of asset for investment by Insurers. Indian Insurers should not be denied the opportunity to invest in this class of asset and diversify their asset allocation.

Considerable similarities exist between Venture Capital Funds (in which Insurers were earlier permitted to invest) and Category I Funds & Category II Funds. Both are permitted to accept investments to invest in unlisted Indian companies from a view to promote growth and exit at the appropriate juncture. However, it must be noted that numerous erstwhile Venture Capital Funds or new Funds launched by existing and reputed Venture Capital Funds are being structured or restructured as Category II Funds and not Category I Funds (even though they might be predominantly focusing on sectors/stages enlisted for Category I Funds) due to relatively narrow sectoral/early stage mandate defined for Category I Funds, thereby increasing the risk profile of such funds *vis-à-vis* Category II



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Funds, which doesn't have this narrow sectoral/early stage limitation. If we try to classify existing Venture Capital Funds into Category I Funds & Category II Funds, then most of the capital committed under various Venture Capital Funds will get classified as Category II Funds. Furthermore, Category II Funds in no way present a greater investment risk for Insurers as compared with Category I Funds. If anything, they are likely to be less risky as Category II Funds are likely to invest in larger and later-stage companies which present a lower venture risk.

It is quite apparent that there are certainly parallels between Venture Capital Funds and Category I & Category II Funds. We believe that the purpose of the 2013 Letter was clearly to extend the earlier VCF regime in relation to Insurers, once the AIF Regulations were legislated.

However, via the issuance of the 2013 Letter, the investment opportunities that were earlier available to Insurers have effectively been limited, as funds which are now classified as Category II Funds are not open for investment from Insurers.

While it is apparent from the 2008 Investment Circular (IRDA's Circular No INV/CIR/008/2008-09) and the 2011 Letter that the intention of the IRDA is to direct Insurer's to invest in Venture Funds, Infrastructure Funds and SME Funds, it must be noted that these funds may also be structured as Category II Funds for the reasons enumerated above. In light of this and facts enumerated above, it is our representation and request to the IRDA, vide this Letter, that **the permission granted to Insurers under the 2013 Letter to invest in Category I Funds should be extended to permit Insurers to invest in Category II Funds as well.** This will go a long way in improving the risk return profile of Insurers investment in AIFs and also helping the formation of domestic pools of growth and development capital.

We look forward to a positive response with respect to the aforementioned request.

Yours Sincerely

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Mahendra Swarup

President, IVCA