NEWS

Sebi asks PE, VCs for info on special pacts

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Synopsis

The capital market regulator wants to know all deals that private equity (PE) and venture capital (VC) funds have separately cut in the past two years with larger investors picked from inside and outside the fund pool.

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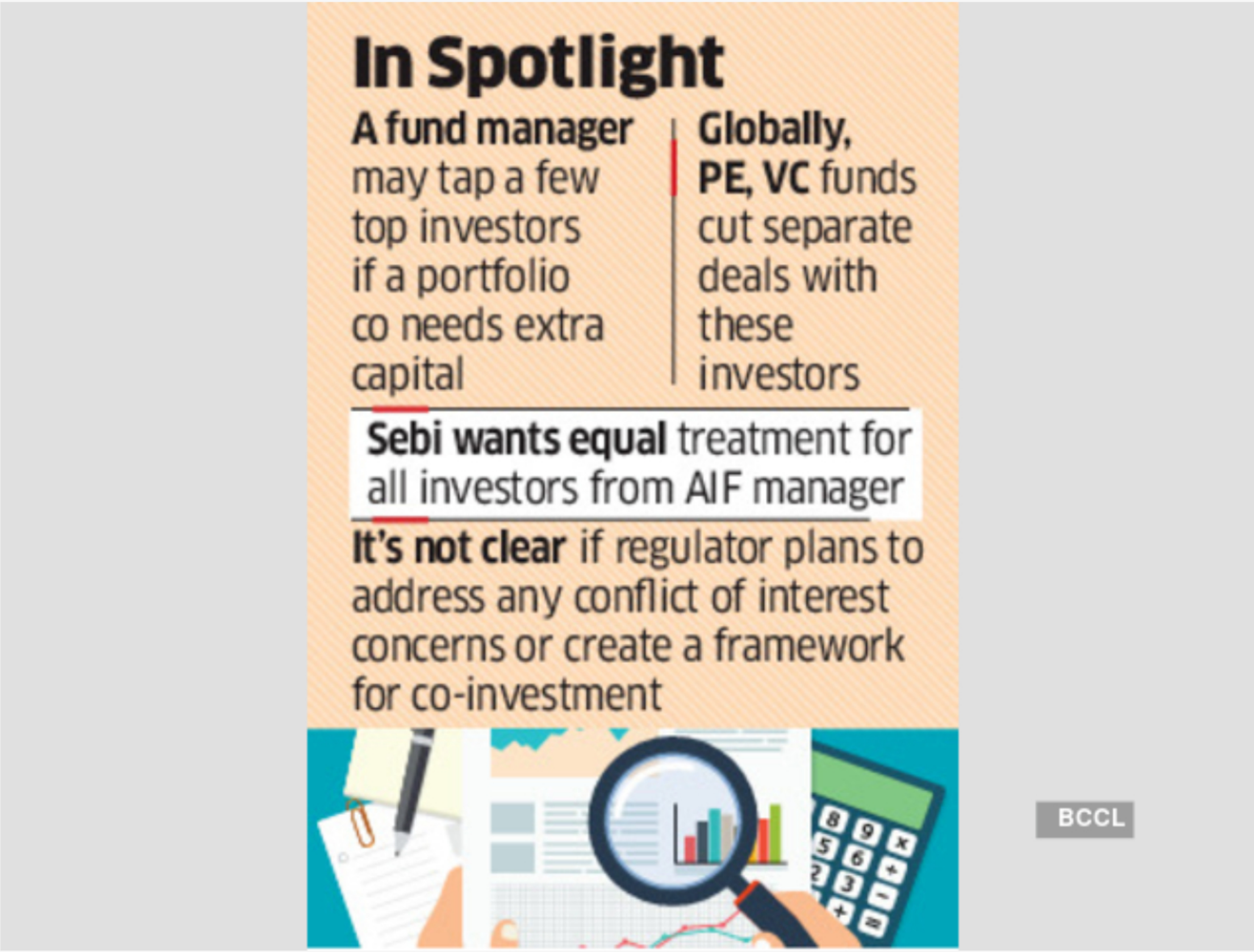
Mumbai: The capital market regulator wants to know all deals that **private equity** (PE) and **venture capital** (VC) **funds** have separately cut in the past two years with larger **investors** picked from inside and outside the **fund** pool.

Ultra high net worth individuals (HNI) and institutional investors at times enter into 'co-investment' agreements with fund managers over and above contributing to the blind pools of alternative investment funds (AIFs) — the regulatory term for PE, VC and angel funds.

In an email to all AIFs on Tuesday, the Securities and Exchange Board of India (**Sebi**) asked them to disclose information on co-investments made by various co-investors from April 1, 2019 to March 31, 2021 in unlisted securities of investee companies. The funds were told to share the information the next day.

It's unclear whether compiling the information is driven by possible regulatory concerns — such as conflict of interest or bias of the fund manager — or any plan to create a framework for co-investment.



'Industry for Segregated Portfolios'

"Investors, particularly the large and strategic ones, are increasingly demanding co-investment rights from AIF managers as it is a globally prevalent practice. Several portfolio entities require larger pools of investments which investment managers may be unable to raise in the blind diversified pool of an AIF and co-investments can become the critical source of funding in such cases. However, there are certain limitations in Indian regulations which do not recognise globally acceptable 'special purpose or side-car vehicles' which can have a single investor or pool of investors and can make select investments. A separate co-investment class within an AIF would have been an ideal solution but has been a subject matter of debate for a while now with the regulator," said Tejesh Chitlangi, senior partner, IC Universal Legal.

Among different situations co-investment happens when a portfolio company needs extra capital but the fund is unwilling to commit. In such a case, the manager solicits the interest and participation of a few top investors in the fund (or even outside the fund).

However, Sebi is against some investors getting a better deal — like lower fees or carry — than others in a fund. Carry is the profit shared with the manager if a fund performance exceeds a hurdle rate. The regulator wants all units issued by an AIF to investors to be fungible with no special class of units given to select investors.

"The recent information sought by Sebi is more detailed than what AIFs share in quarterly reports. It could be to ascertain whether fund managers are going beyond the permitted blind pool structure and raising capital on a deal by deal basis. An AIF fund manager in the GIFT City is allowed to create segregated portfolios in a GIFT AIF for purposes of offering co-invest opportunities. There has been a long standing ask by the fund industry to allow segregated portfolios in domestic AIF structure as well. This will provide more capital flexibility for deals and allow co-investment on a transparent basis," said Parul Jain, who heads funds formation practice at the law firm Nishith Desai Associates.