Corpsec Hotline

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VENTURE FUNDS TO BE SUBJECTED TO IPO LOCK-IN

The Securities and Exchange Board of India ("SEBI") has, at its Board meeting held in Mumbai on Monday, June 26, 2006, issued Press Release 166/2006 which inter-alia announced its decisions to introduce changes in the lock-in period post Initial Public Offerings ("IPOs") for SEBI registered Venture Capital Fund ("VCF") and SEBI registered Foreign Venture Capital Investors ("FVCI"). As per the Press Release, VCF/FVCI would now, be exempt from lock-in requirements only if they hold the shares for a period of at least one year at the time of filing of draft prospectus with SEBI.

Analysis

As of today, Clause 4.14.1 of the SEBI (Disclosure and Investor Protection) Guidelines, 2000 ("Guidelines") impose an obligation on the promoters, to lock-in their shareholding to the extent of 20 per cent of post-issue equity capital pursuant to an IPO. The Guidelines also prescribe locking-in of entire pre-issue equity capital over and above the mandatory 20 per cent lock-in by promoters, whether held by promoters or others.

Presently the only exemptions from the lock-in provision are under clause 4.14.2 of the Guidelines to:

- shareholding of VCF/FVCI;
- shares issued under employee stock option scheme to non-promoters; and
- shares being offered for sale held for one year or more.

However, with the proposed amendments SEBI has decided that the exemption under clause 4.14.2 of the Guidelines would be available only for those VCF/FVCI, which are holding the shares for a period of at least one year at the time of filing of draft prospectus with SEBI up to the IPO. The underlying rationale of lock-in provisions on significant shareholders has primarily been to protect participants who purchase the shares in public issue from adverse pressure on market float if the regulations had allowed the promoters/other shareholders to freely sell their shares upon listing.

Further the exemption for VCF/FVCI from the lock-in was to give flexibility to players who invest in companies at a growth stage and work closely with the company in building value into the company; to encash upon the listing of the shares. However SEBI seems to have been of the view that this exemption was being abused in spirit and these structures were used for pre IPO investments, which were done with a short-term objective of only making gains for the investors.

Implications

The decision to impose the lock-in restrictions on VCF/FVCI indicates that SEBI is of the opinion that VCF/FVCI are exploiting the existing provisions of law. By limiting the benefit of the exemption to those VCF/FVCI who have held their shares for at least one year as discussed above, the SEBI has indicated that it wants to only encourage investors who have a long-term perspective and not merely for profit booking.

- Jitender Tanikella & Ruetveij Pandya
You can direct your queries or comments to the authors

Source: SEBI Press Release - 166/2006, "SEBI Board approves (1) guidelines for Real Estate Mutual Funds and (2) Changes in Venture Capital Fund lock- in period for IPOs", Mumbai June 26, 2006

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