INDIA – RECENT SECURITIES LAW DEVELOPMENTS

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1. Dematerialization of physical securities of shareholders before filing the DRHP

The Securities and Exchange Board of India (the "**SEBI**") has, recently, approved amendments to the SEBI (Issue Capital and Disclosure Requirements) Regulations, 2018 (the "**ICDR Regulations**"), and has mandated that selling shareholders, key managerial personnel, senior management, directors, qualified institutional buyers ("**QIBs**"), employees, shareholders with special rights and all entities regulated by financial sector regulators, should dematerialize their shares before filing the Draft Red Herring Prospectus ("**DRHP**"). This move is expected to, *inter alia*, facilitate faster share transfers, eliminate the loss of and damage to physical securities, enhance transparency, and reduce fraud and forgery.

Prior to the proposed amendment, only promoters were required to hold their shares in dematerialized form before filing a DRHP.

2. Relaxation of public issue and promoter-related norms to ease reverse flipping and founder ESOP continuity

As part of its ongoing efforts to promote the ease of doing business, the SEBI has approved key amendments to the ICDR Regulations and the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021, aimed at easing restrictions on public issues, especially in cases involving reverse flipping and founder equity incentives:

(i) Firstly, the SEBI has exempted from the requirement of holding for one (1) year equity shares to be sold in an offer for sale ("**OFS**") those equity shares arising out of the conversion of fully paid-up compulsorily convertible securities ("**CCS**") received under an approved scheme. This will allow investors holding CCS to convert their CCS before an OFS and participate in it. This move will aid CCS holders in companies that undergo a reverse flip to be based in India just before listing.

(ii) Secondly, the SEBI has added more entities into the definition of "relevant persons" for the purposes of minimum promoter contribution. "Relevant persons" such as alternative investment funds ("**AIF**"), foreign venture capital investors, scheduled commercial banks, insurance companies registered with the Insurance Regulatory and Development Authority of India, public financial institutions and non-promoter shareholders forming part of the promoter group, any non-individual public shareholder holding at least 5% of the post-issue capital, or any entity (individual or non-individual) forming part of promoter group other than the promoter(s) will now be permitted to contribute equity shares arising from conversions of fully paid-up CCS towards the minimum promoter contribution. Under the existing framework, only promoters of a company could contribute equity shares arising from conversion of fully paid-up CCS to fulfil the minimum promoter contribution. This amendment

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now aligns the treatment of promoters and significant non-promoter contributors for minimum promoter contribution compliance.

(iii) Thirdly, in a significant relaxation, the SEBI has addressed the hardship faced by founders classified as promoters who were required to liquidate employee stock ownership plans or other share-based benefits held at the time of DRHP filing. Going forward, founders who have been granted such benefits at least one (1) year prior to filing the DRHP may continue to hold and/ or exercise these benefits even after being classified as promoters and the company becoming a listed entity.

3. <u>Angel fund framework revamped to align with accredited investor norms and enhance fundraising flexibility</u>

The SEBI has approved a revised regulatory framework for angel funds under the SEBI (Alternative Investment Funds) Regulations, 2012 (the "**AIF Regulations**"). While retaining angel funds within the AIF regime, the SEBI has introduced key changes to eligibility norms, investment thresholds, and compliance requirements.

The key regulatory changes include:

(i) **Accredited investor requirement**

Going forward, angel investors will now be required to be accredited investors to be able to invest in angel funds.

(ii) **Inclusion of angel investors as qualified institutional buyers for angel funds**

The SEBI has approved an amendment to the ICDR Regulations to allow angel investors to be treated as QIBs for the limited purpose of investing in angel funds, thereby expanding the potential investor base for angel funds, while remaining compliant with the Companies Act, 2013. Section 42(2) of the Companies Act, 2013 excludes QIBs from the limit of two hundred (200) persons in respect of offers to subscribe to securities by way of private placement. Earlier, the limit on the number of investors (including angel funds) to two hundred (200) adversely impacted capital inflows into start-ups. Now that angel funds have been categorized as QIBs, they will be outside the two hundred (200) investor limit prescribed under company law.

(iii) **Operational reforms for angel funds**

The SEBI has also approved the following operational reforms for angel funds:

(a) **Relaxed investment thresholds**: The floor and cap for investment in an investee company have been revised from INR2,500,000 (Indian Rupees Two Million Five Hundred Thousand) to INR100,000,000 (Indian Rupees One Hundred Million) to a higher range of INR1,000,000 (Indian Rupees One Million) to INR250,000,000 (Indian Rupees Two Hundred and Fifty Million).

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(b) **Removal of concentration limits**: The previous restriction limiting investment in a single company to 25% of the angel fund's total investment has been removed.

(c) **Wider investor participation**: Angel funds can now accept contributions from more than two hundred (200) accredited investors in a single investment, easing scale limitations.

(d) **Follow-on investments permitted**: Angel funds can make additional investments in companies that have outgrown start-up classification.

4. Co-investment schemes under AIF structure for Category I & II AIFs now permitted

The SEBI has approved an amendment to the AIF Regulations allowing Category I and Category II AIFs to offer co-investment schemes ("**CIV Schemes**") within the AIF regulatory framework to facilitate AIFs and investors to co-invest and support capital formation in unlisted companies through AIFs.

Under the new framework, a co-investment scheme refers to a scheme of a Category I or II AIF that facilitates co-investment by accredited investors of a particular AIF scheme into unlisted securities of an investee company in which the AIF scheme is already invested. For example, if an AIF scheme invests INR1,000,000,000 (Indian Rupees One Billion) into a company, and the total funding requirement is INR3,000,000,000 (Indian Rupees Three Billion), accredited investors of the AIF scheme may be offered the opportunity to co-invest the balance INR2,000,000,000 (Indian Rupees Two Billion) through a CIV Scheme in addition to their investment through the AIF.

Currently, such co-investments are made through co-investment portfolio managers under the SEBI (Portfolio Managers) Regulations, 2020, which poses operational challenges, such as dual registration requirements for fund managers (as AIF and portfolio manager), and complexity for unlisted companies dealing with numerous shareholders. The new AIF-based route seeks to address these issues by enabling co-investment directly through the AIF vehicle.

A separate CIV Scheme will be required for each co-investment opportunity, ensuring clear segregation and governance, and certain regulatory relaxations applicable to other AIF schemes will apply to CIV Schemes.

5. Extension of the liquidation period for VCFs migrated to the AIF regime

By its circular dated June 6, 2025, the SEBI has extended the liquidation period for venture capital funds ("**VCFs**") migrating to the AIF framework by one (1) year, i.e., from July 19, 2025 to July 19, 2026. This extension, granted after consultations with industry stakeholders, gives VCFs more time to wind down legacy structures and align with the AIF framework. However, the deadline for eligible VCFs to apply for migration continues to be July 19, 2025.

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In 1996, the SEBI notified the SEBI (Venture Capital Funds) Regulations 1996 (the "**VCF Regulations**") to encourage investment and funding in early-stage companies in India. However, with the introduction of the AIF Regulations, the VCF Regulations were repealed. Despite the repeal, existing VCFs were permitted to continue under the VCF regime, subject to certain conditions. The AIF Regulations also offered such VCFs an option to re-register and operate under the AIF regime.

To facilitate this transition, the SEBI notified certain amendments to the AIF Regulations in 2024, providing a structured mechanism for VCFs to migrate to the AIF regime, and allowing VCFs migrating to the AIF regime who had at least one (1) scheme that had not been wound up post expiry of its liquidation period under Regulation 24(2) of the VCF Regulations, additional time to liquidate until July 19, 2025.

While the window for liquidation has been extended, the SEBI has clarified that all other provisions of its August 19, 2024 circular remain in force, and no relaxation has been granted with respect to the eligibility conditions or application timelines for migration into the AIF framework.

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