Banking & Finance DIGEST

Issue No. 9 November 2011

Evolving Dynamics in India's M&A Landscape

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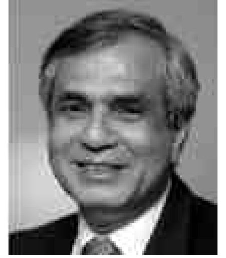
PREFACE



The Banking & Finance Digest aims to supplement FICCI's firm resolve in acting as a catalyst for enabling policy changes critical for the growth of Financial Sector in India. Through the Digest, FICCI endeavors to facilitate a comprehensive forum for dialogue amongst the Indian Inc. and the Government thereby providing necessary directions to policy makers and business processes. The issues discussed herein are invaluable inputs for FICCI's extensive network of industry members and stakeholders. This issue of our digest aims to bring to the forefront perspectives of experts from India Inc. and financial sector intermediaries on the ***'Evolving dynamics in India's M&A landscape'.***

India Inc. has come a long way these 20 years since the beginning of economic reforms. Economic integration with the world has opened up avenues for India Inc to expand our global footprint while also providing foreign corporations an opportunity to reap rich demographic dividends. The tremendous increase in M&A, over the recent years, is linked just as closely to the evolution of an accommodating policy regime as it is to the economic growth story. The recent developments on the regulatory side bode well for the business environment and growth aspirations of India Inc. FICCI believes that healthy regulation of M&As in the corporate sphere would not only provide for the promotion of entrepreneurial spirit among our stakeholders, fulfill investor interests and contribute to the overall economic growth of the nation.

However, in the current scenario, increasing cost of debt, restrictions on Indian banks and issues related to tax and government approvals have impeded the growth of M&As in India. The need of the day is accelerated reforms, especially in the financial sector, greater clarity and perhaps a more nuanced, thoughtful approach that takes into account market realities.

Through the voice of some of India's leading names in the financial sector, this issue deliberates on the possible way forward on the legal, financial and taxation issues in India's M&A Industry.

We thank our partner MCX Stock Exchange for extending their support to help achieve our endeavor.

We do look forward to views and suggestion from the readers to help us improvise the content of the digest and make it more relevant and informative.

Dr. Rajiv Kumar

Long journey ahead

In the two decades since economic reforms, while a lot has changed in India and particularly in the M&A space, we still have a long way to go.

Rashesh Shah, Chairman and CEO
Edelweiss Group

This year marks two decades since India embarked on an economic reforms programme. While the reforms process seems to have slowed down in the last couple of years, and most people from the industry -- this writer included -- have repeatedly urged the government to take urgently needed steps to further liberalize the economy, as we near the end of 2011, it might make sense to take pause and reflect on the journey that the economy has travelled in the last twenty years.

If you look back, in pre-liberalization industry, it was almost impossible for an entrepreneur to set up a new business. His/her first roadblock was that uniquely Indian and incredibly wasteful concept – a license or permit. So it did not matter that there was a huge market out there, it did not matter that existing players were exerting monopoly powers and selling shoddy products at inflated prices, it did not matter for such "luxury" goods like two wheelers, there was a 15 year waiting period for allotment. No license, no business.

Even existing businesses were not allowed to expand their capacities since the License Raj governed not just what you produced but how much you produced. It was not the dynamics of demand or supply, but some "sage" mandarin in Delhi who decided the optimum level of production for all industries. And all this was done in the name of efficiency!

In these circumstances, there was little role for any corporate finance professional. There were three "Development Finance" institutions which provided project financing. Banks provided working capital debt and that was that.

Equity offerings were controlled by an institution called the Controller of Capital Issues, which determined the "fair" price for the issue. As a result most initial public offerings were underpriced and most often getting an allotment was like winning a lottery since the shares always listed at a premium to the issue price. Selling such an issue was therefore a no-brainer.

In classical terms, the financial services industry is really a bridge between savers of capital – households and corporates -- and users of capital – companies and government. The more efficient this bridge – the financial services industry is – the more effectively it will channelize savings into productive use resulting in capital formation.

If you go by this definition, the economic reforms process initiated in the early 1990s can be regarded as birth of a modern finance services industry in India. By de-controlling the entire system, it allowed businesses to flourish. Existing companies could look to expand their operations, enter newer markets, and add capacities. Talented entrepreneurs with little or no access to money could dream of starting out on their own. All they required was an idea and execution capabilities.

What used to be the biggest roadblock – capital, was no longer so. Multiple avenues of funding are available and a whole legion of finance professionals which could help these companies/entrepreneurs tap these avenues.

Two decades since the launch of the economic reforms programme and the business and economic scenario in India has unalterably changed. Companies today have access to a whole range from funding options beyond the traditional term loans or public equity offerings. These range from venture funds, private equity funds, hedge funds, mezzanine funds to commercial paper to deep discount bonds etc. And their efforts to raise funds no longer are restricted to India. Foreign Financial Institutions (FIIs) have been making a beeline into India and are happy to get in early on good opportunities. Companies/entrepreneurs also have the option of raising funds internationally through a variety of instruments and avenues.

The results are self evident. In 1991, the market capitalization of the Bombay Stock Exchange was about USD 50 billion. By the end of FY11 this had gone up to approximately USD 1.5 trillion. Average daily turnover in the cash segment – the only one allowed in 1991 -- was in the region of USD 4 mn. By the end of FY11 this average daily turnover had gone up to approximately to USD 5bn in the cash segment and about USD 20bn in the F&O segments. Even adjusting for the fall in value of the Rupee from Rs. 18 in 1991 to Rs. 45 in 2011, the rise in the stock market activity is staggering.

Prior to the economic reforms, Mergers and Acquisitions activity in India was almost non-existent. Remember the brouhaha that erupted with Swaraj Paul tried a hostile takeover of Escorts and Delhi Cloth Mills back in the 80s? But along with the economic landscape, this too has changed.

Today M&A activity has become a routine part of doing business. As we all know, several Indian companies have been involved in marquee, hotly contested international deals. In the last five years alone we have seen over 2,000 deals totally valued at about $160 billion which involved Indian companies either as buyers or sellers or both. M&A activity where both the seller and acquirer were Indian companies has also been pretty common.

What has aided this process is the formation of the Securities and Exchange Board of India and its guidelines on takeover which has leveled the playing field. The main objective of a code to govern takeovers of listed companies is to ensure that the interests of minority shareholders are protected. Yet there were some lacunae in the code which SEBI has tried to address through the amendments announced earlier this year. These amendments have removed some anomalies and made the process far more logical.

The minimum trigger for the open offer has been raised from 15% to 25%. The amendment also mandates that the minimum offer should be for 26% of the residual stake. The earlier provision of 15% was too restrictive and made it very difficult for Private Equity Funds and other strategic investors to invest in small or medium cap companies. Also the trigger of 15% was not in synch with any legal threshold status as the key legal threshold holding in any company is 25%, 50% and 75%.

The recent changes make the whole thing much more logical. If one entity or group of entities holds 25% shares of a company, then it can block any special resolution. Therefore it seems logical that an open offer be triggered only when someone acquires such powers. And by ensuring that the open offer is for a minimum of 26% of the outstanding shares, the regulator has ensured that the acquirer needs to aim for at least majority control.

The amendments have also banned the paying of any non-compete fees. At one level this makes sense since admittedly the provision of non-compete fees has been misused in the past. It has resulted in the promoter group -- which may be selling its stake -- getting a far higher price than the price paid to minority shareholders. The amendment levels this field.

However there has been some criticism of this move as it has been felt that when a controlling stake is sold and certain non-compete clauses are imposed on the seller, these have certain economic value beyond the share price. The fact is very often people with a considerable stake in a company signify some extra value for the acquirer - that person could be a technology innovator, a progressive leader and/or manager with in depth understanding of the business and the environment, etc. A control premium/non-compete fee is often recognition of this reality. It was also felt that perhaps the regulator could have taken a more nuanced approach – whereby this non-compete fees could have been allowed subject to some cap. Another idea was to get minority shareholders to vote on a non-compete where the promoter -- being an interested party – cannot vote on the motion.

While it hasn't happened yet, one possibility is that the ban on non-compete fees may result in a bigger market for Differentiated Voting Right (DVR) shares. So far a few companies have issued such shares, but the market, unsure how to treat them, tends to discount them by almost 35-40%. SEBI's decision is likely to increase issuance of DVR shares. Though DVR has some regulation clarity issues – such as, do DVR share participate in open offers? - This recent move may give a boost to DVR issuances.

The big handicap that Indian companies suffer in any M&A battle is of course of funding. In fact this is why most Indian companies heaved a collective sigh of relief when SEBI rejected a recommendation of committee it had appointed to recommend amendments to the takeover code.

The committee giving preponderance to the interests of minority shareholders had recommended that all open offers should be for 100% of the outstanding shares. This was because the committee felt anything less would put the promoters – who could sell their entire stake and thereby trigger an open offer -- at an advantage viz a viz the minority shareholders who may not be able to sell their entire stake in the company.

This recommendation if implemented would not only have made takeovers more expensive, but would have also put Indian acquirers at a distinct disadvantage versus their global competitors. This is because banks in India are not allowed to fund a takeover while there is no such restriction on a MNC which could quite easily raise bank funds from outside India -- very often pledging the assets of the target company.

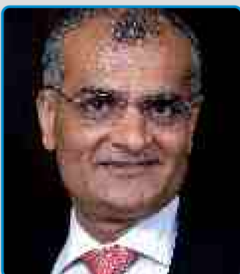
So while the SEBI final decision of keeping the minimum open offer level at 26% was welcomed by India Inc., it is still felt that the government and regulators like the Reserve Bank of India need to re-look at the blanket ban on banks in India funding takeovers. Admittedly the kind of leveraged buyout binges that we tend to see in the US every decade or so, harm the economy and need to be restricted. But again the answer perhaps lies in a more nuanced approach that allows

bank funding while taking into account the specifics of the situation in terms of the buyer, the seller, the strategic fit of the acquisition, the amount of leverage etc.

Taxation and M&A have always had a controversial relationship, around the globe. The classic case of course is of course the bid by First Boston (as the investment bank was called then) in the epic RJR Nabisco leverage buyout battle in the late 80s. A significant part of the funding for their bid in the battle was based on an almost expired tax loophole. If the bid had succeeded, it is believed that it would have resulted in the US fiscal deficit increasing by two per cent.

In India probably the most celebrated case related to taxation and M&A is the battle between Vodafone and the Income Tax department which has been winding its way through the judicial system. The IT department has claimed that Vodafone failed to deduct tax at source while concluding the deal and has demanded that Vodafone pay $2 billion in taxes, a claim that the telecom giant has contested. The battle is now in the Supreme Court and its decision is keenly awaited as it would have wide ranging ramifications on M&A activity in India.

To sum up, I believe we have travelled a long way in the last 20 years since economic reforms process began. But what we are only at the end of the beginning. There is still a long way to go if we have to realize the full potential of the Indian economy and Indian entrepreneurship. What are needed are accelerated reforms, especially in the financial sector, greater clarity and perhaps a more nuanced, thoughtful approach that takes into account market realities.



Rashesh Shah
Chairman and CEO
Edelweiss Group

Rashesh Shah, Chairman and CEO of the Edelweiss Group has over twenty years of experience in financial services in India. Rashesh cofounded Edelweiss in 1996 and the group has grown into a large diversified financial services house offering Credit, Capital Market, Asset Management, Housing Finance and Insurance. Edelweiss has a net worth of about $500 Mn, and employs over 3,000 people across about 300 offices.

Rashesh has served on the Boards of various companies and public institutions. He has in the past served on the Executive Committee of the National Stock Exchange and has recently been appointed as Chairman, Maharashtra Council of FICCI. Besides this he is also Chairman of the Capital Market Committee of FICCI. He also chairs the National Council on Capital Markets formed by ASSOCHAM. He has been nominated to the Executive Committee of a proposed US - India Investors Forum.

A MBA from Indian Institute of Management, Ahmedabad, Rashesh also holds a Diploma in International Trade from the Indian Institute of Foreign Trade, New Delhi. Among the several accolades Rashesh has received, are the 'Entrepreneur of the Year' award from Bombay Management Association (2008-2009) and the 'Special Award for Contribution to Development of Capital Markets in India' by Zee Business at the India's Best Market Analyst Awards, 2011.

Perspectives on India's M&A landscape

Raja Lahiri
Partner, Transaction Advisory Services,
Grant Thornton,
with inputs from Vaibhav Gupta

While the global economic environment is under pressure, the growth story of India continues on the back of domestic demand and consumption. India is projected to register a growth rate of over 7.5% in the current fiscal, which indicates that Indian companies are positive about their business prospects. Though high inflation, currency devaluation, corruption and governance related issues remain a concern, the long-term economic fundamentals of the country are intact.

On the flip side, the regulatory environment of India is undergoing significant changes. Whether it is International Financial Reporting Standards (IFRS), eXtensible Business Reporting Language (XBRL) or New Companies Bill, Indian companies could expect a massive phase of consolidation in the regulatory environment under which they operate. Mergers and Acquisitions (M&A) are no exception.

Introduction of new guidelines by the Competition Commission of India (CCI) and Securities and Exchange Board of India (SEBI), for instance, could impact radical changes in the dynamics related with the M&A transactions. Amidst these structural changes, Indian M&A landscape is clearly witnessing some key trends in recent times, which are set out below.

Indian promoters are now willing to exit their businesses – change in attitude and attractive valuations are expected to trigger more M&A

A clear trend that is emerging now is the strategic shift in the behavioural pattern of Indian entrepreneurs, who are now more willing to sell a part or whole of their stake to exit their businesses to foreign players. Attractive valuations from foreign players, given the significant growth opportunity in India, are prompting Indian entrepreneurs to evaluate exits. In my view, this is a significant shift in attitude and behaviour of Indian entrepreneurs who have the open mind to evaluate strategic buyers to exit their age-old businesses and this trend is expected to continue.

Case in point of successful exits by the Indian promoters includes Daiichi-Ranbaxy and Abbott-

Piramal. British Petroleum's equity stake in Reliance Industries is one of the largest deals of 2011, which demonstrates the desire of Indian promoter group to bring in foreign technology and capital to enhance business capabilities.

In my view, the era of global collaborations and partnerships would become even more vital now than ever before.

Governance becoming an important driver for M&A deal closures

The Satyam saga and now the 2G Telecom scam now are clearly putting a strain on the Corporate Governance concerns of the Indian Corporate world. In my view, while there are significant strategic interests of Corporates from the US, Europe, Japan etc. in Indian companies and the Indian growth story, some of the ambiguous corporate governance practices do end up creating problems for the International Corporate transactions.

Due diligence on transactions are getting more robust, with in-depth coverage limited not only to the financial, commercial, tax and legal aspects of a transaction, but also extending to promoter background checks on ethics and corporate governance practices. It is, therefore, imperative that Corporate India and entrepreneurs, who are looking to exit their business or planning to induct strategic players, focus towards enhancing their corporate governance practices.

Private Equity playing a key role in the Indian M&A landscape

Another trigger for M&A which we are witnessing is PE backed companies who are looking at M&A options to facilitate exits for the PE's. Moreover, large PE's are providing the necessary source of capital to finance M&A deals. The case in point is the I-Gate Patni deal which was part financed by Apax Partners.

Metals and minerals would continue to be important for India's national policy, especially the overseas coal assets for the power sector

The demand for power is increasing, but the lack of proper coal supply linkages is proving to be a major bottleneck in the production. In my view, we would see an increase in outbound deals by the Indian Corporates looking at overseas coal and mineral assets. Deals that have concluded in 2011 in the power sector include GVK Power's acquisition of Hancock Coal in Australia for US$ 1.26 billion and GMR's acquisition of Indonesian coal assets for US$ 550 million.

New Competition Law (CCI Guidelines) could potentially delay M&A deal closures

The New Guidelines by CCI is a welcome step to bring in checks on competition. In my view, while the objective of the Guidelines is well taken, the key here would be the execution of the guidelines to enable smooth approval process of M&A transactions.

At the outset, the Regulations seem to consider size as the only

measure of monopoly, implying a belief that only large monopolies are harmful. In my view, market share would prove a more comprehensive measure in scrutinizing the existence of a potential monopoly.

While the Regulations state that during the appreciable adverse effect analysis, the CCI will also look into other factors such as the relative market share, this still leaves out some loopholes. In the case of highly specialised small markets, two entities could combine to form a monopoly, and still remain outside the CCI scanner due to their small size.

Secondly, though the time limit for the CCI review has been reduced to 180 days, this could still be considered more of an optical reduction, since the outer time limit for passing judgment has been retained at 210 days. Further, both 180 and 210 days are in themselves relatively long periods in the of M&A, given the current volatile global environment.

Finally, it is crucial that the CCI be able to attract the requisite pool of talented manpower, including, and not limited to, economists, lawyers, bankers and corporate strategists, whose combined wisdom would be required to resolve issues involved in the making complex decisions. Else, under the provision to appeal against the CCI's decision, it is possible that the CCI's decision be overturned by Tribunals or Higher Courts, thereby, only staggering the M&A activity, and undermining the authority of the CCI.

New SEBI Takeover Code increasing the open offer trigger to 25% levels a welcome step, however, Indian promoters would need to be cautious

The New SEBI Takeover Code aims to enhance the threshold limit from 15% to 25%, and the open offer size, after the 25% trigger is hit, is enhanced from the current 20% to 26%.

In the case of Hotel Leela Ventures, where ITC currently holds 14.5% stake, under the new norms, ITC can hike its stake by another 10% and still stay away from making an open offer for additional 26%, as would be required now. More interesting would be the case of EIH Ltd - the hospitality company, which owns and operates the Oberoi chain of hotels - wherein Reliance and ITC are currently holding 14.5% stake each.

However, if an acquirer acquires at least 25% stake in a company, then he has to come out with a minimum open offer of 26%. This will result in making an acquirer ending up with "controlling" 51% stake in the target company.

Once the code takes effect, promoters will have to stay alert, as acquirers and private equity players can acquire stakes up to 24.9% without triggering an open offer. Many Indian promoters run their companies with stakes in the range of 20-30%, and they may now need to strategically think of increasing their equity holdings.

For smaller investors, removal of non-compete fees is in line with the recommendation of the Takeover Committee- . This recommendation is welcome and serves the purpose of protecting the interests of minority shareholders.

Tax Litigation and implications for M&A

The judgments in the cases of Vodafone and Aditya Birla cases provide various lessons for anybody looking to make investments in India.

These decisions are a clear mark of a trend to tax international transactions that have an India nexus, however remote, by lifting the corporate veil and limiting the benefit afforded by the India-Mauritius tax treaty.

Vodafone, Aditya Birla and others have appealed to the Supreme Court of India against the decisions of the Bombay High Court. Hearing of the Vodafone appeal has already commenced and is ongoing, the Supreme Court is expected to make a decision sometime in the next few months. This judgment of the Supreme Court would decide the future of the international transactions in India.

These cases exemplify how poor tax structuring of India-related transactions can result in high tax exposures to buyers and sellers alike.

However, these judgments offer the following learning points for making any investment or in India.

Lesson No. 1 – It is imperative to structure any investment in India through a company located in a jurisdiction, which provides favourable tax treatment.

While the India-Mauritius tax treaty still remains the preferred source for routing investments to India, countries like Singapore, Cyprus and The Netherlands, etc. have also entered into favourable tax treaties with India, which may offer various degrees of protection from taxes in India on exit.

Lesson No. 2 – Substance should be created in the company in the treaty jurisdictions.

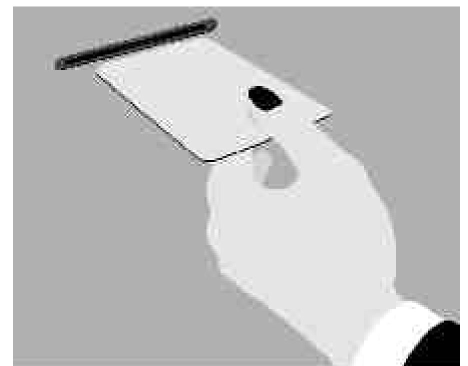
Substance bolsters the applicability of the protection afforded by these treaties.

As evidenced in Vodafone and Aditya Birla, the courts will treat the treaty as inapplicable where they believe that there is no substance to the company relying on treaty benefits. Effective management and control over the investment must be vested in the treaty jurisdiction holding company so as to be recognised by the Indian tax authorities.

Lesson No. 3 –
Legal documentation and information disseminated publicly relating to the transaction must be carefully crafted by the parties so that the rights and obligations come to vest in the intermediary country, entity unlike in the Aditya Birla case, where the Mauritian entity was never a party to the original joint venture agreement or the shareholders' agreement. and that all obligations and liabilities under the agreement ultimately were of its parent company.

Lesson No. 4 – When the timing of the transaction permits, interested parties should approach the Indian tax authorities for an advance ruling as to the applicability of tax in India, to the transaction.

Lesson No. 5 – Buyers should seek indemnification with respect to any Indian taxes applicable to the transaction from sellers. Such indemnification should be supported by an escrow, when possible, under the terms of the deal as under the Indian tax laws, it is the responsibility of buyer to withhold tax but ultimate liability to pay tax would always be that of the seller.



Lesson No. 6 – In case of global acquisitions where India operations would form a minor part of the deal, it may be imperative that India-related assets and rights are segregated from other aspects of the transaction, with separate costs attached to such assets.

Doing so may limit any tax liability to those assets and rights that have a true India nexus.

There was a public-interest litigation filed in the Delhi High Court against Kraft Foods for tax evasion relating to its US$19 billion takeover of Cadbury, which was entirely a case of sale of shares of a foreign company to another foreign company, with just a small portion of the deal connected to India. According to the lawsuit, the brand's goodwill, franchise, market share, customer lists, relationship and the value of market, etc. are capital assets being transferred in India and therefore, Kraft is under the obligation to deduct the income tax, while making payment for the acquisition.

M&A in certain sectors like telecom, aviation etc and capital inflows in certain sectors like retail need to be encouraged by enabling regulations for economic interests

A common public debate on FDI in retail has unfortunately been again put on the back burner by the Indian Government. In my view, India story has to mature and foreign capital is necessary not only to enhance the retail networks but also to build the back-end infrastructure.

Given the number of telecom players operating in India (in excess of 12) and the operating losses that some of the players are incurring, consolidation through M&A becomes imperative. Telecom being such an important element of Indian infrastructure and communication aspect, M&A Provisions permitting consolidation does become critical. However, the recent Telecom Policy does not mention about the M&A Provisions, which was much awaited by the sectors.

Another sector which possibly requires due consideration from the Indian Government and Regulators is aviation. This is publicly known the losses incurred by some of the key private airline operators in India (notwithstanding our National Carrier, Air India) and increasing losses are becoming difficult to sustain. In my view, serious consideration should be given to this industry to bring in Foreign Capital in national interest.

Given the significant M&A deals in pharma sector in the last 4 years, the Maira Committee was constituted to examine the FDI Policy in pharma, which currently allows 100% FDI with no cap. The committee has recommended giving more teeth to the (CCI) in allowing M&A in the pharma sector and not changing the FDI limit. The Indian Government government has accepted the recommendations and this is clearly a positive step.

Integration for M&A important to achieve the desired results

As Indian companies continue to look for outbound deals to grow, integration planning and strategy would become vital for Indian Corporate, as they elevate to managing larger assets post-acquisition. The learning from the Global M&A deals clearly indicate that poor integration planning and execution is one of the key

reasons for the failure of deals and hence, adequate attention should be paid to bring in global practices for post-merger integration.

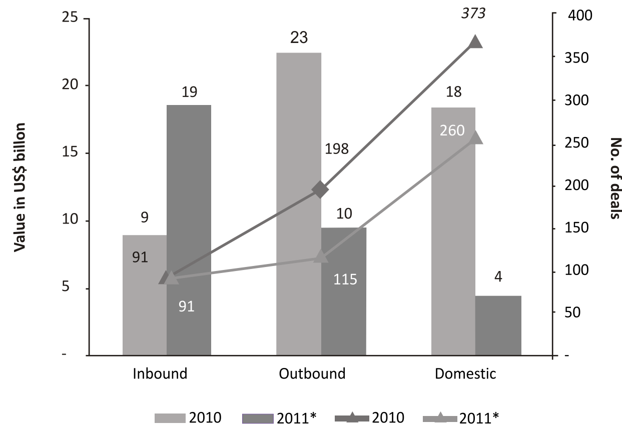
Summing up

In my view, India's M&A would continue to grow stronger and bigger in years to come and our regulations and economic environment should facilitate closure of transactions. As Western economies continue to show signs of weaknesses, Indian corporate should aim at seizing this time and opportunity to strengthen India's market position, while expanding their global footprint.

Exhibit 1

M&A Deal Momentum remains strong but could get moderated

The 1st half of 2011 witnessed M&A deals of US$ 27 Billion as compared to US$ 29 Billion inH1/10, which indicates a fairly strong deal momentum. Set out below is a snapshot of the M&A deals, volume and value for 2010 and 2011 (the first 9 months till 30 September 2011).



Top 5 M&A Deals in 2011

Acquirer	Target	Sector	Acquisition price in US$ Mn	Deal Type	% Stake
British Petroleum	Reliance Industries	Oil & Gas	7,200.00	Strategic Stake	30%
Vodafone Group Plc	Vodafone Essar	Telecom	5,000.00	Increasing Stake	N.A.
Mundra Port SEZ Ltd	Abbot Point Port	Shipping & Ports	1,956.52	Acquisition	
Vedanta Plc	Cairn India	Oil & Gas	1,500,00	Increasing Stake	11%
GVK Power & Infrastructure	Hancock Group-coal mines and a port and rail project	Mining	1,260.00	Majority Stake	79%

Top 5 M&A Deals in 2010

Acquirer	Target	Sector	Acquisition price in US$ Mn	Deal Type	% Stake
Reliance Power Ltd	Reliance Natural Resources Ltd	Oil & Gas	11,000.00	Merger	N.A
Bharti Airtel	Zain Africa BV	Telecom	10,700.00	Acquisition	
Abbott Labs	Piramal Healthcare Solutions- Domestic Formulations Business	Pharma, Healthcare & Biotech	3,720.00	Acquisition	
Hinduja Group	KBL European Private Bankers	Banking & Financial Services	1,863.00	Acquisition	
GTL Infrastructure	Aircel Ltd- 17,500 telecom towers	Telecom	1,787.23	Acquisition	

Source: Grant Thornton DealTracker

Mr Raja Lahiri
Partner
Transaction Advisory Services
Grant Thornton

With 14 years of experience, Mr Lahiri, Partner – Transaction Advisory Services, Grant Thornton India, has been associated with various aspects of deal making. His responsibilities include deal origination and ideation, preliminary analysis, due diligence (financial and commercial), valuation, deal negotiation and advise on deal agreements. He also advises clients on post-deal integration matters and ideation of exits for Private Equity Funds.

Overseas acquisitions by Indian Businesses: Process & Precautions

Gautam Khurana
Partner, India Law Offices

Brief Overview

Outbound Investment of India has witnessed large growth rates over the decade due to liberalizing policies and allowing investment beyond the net worth i.e., investment up to 400% of their net worth into a foreign enterprise. Since 2008-09, Indian Business Houses have more focusing on cross border transactions and looking for a new investment destination for both market & resources. Indian players actually benefited from the global downturn as compared to the rest of the world. The leading destinations for India's Outward Investment have been Singapore, Mauritius, Cyprus, the Netherlands, the United States, the British Virgin Islands and the Channel Islands.[1]

"Recent data released by the Reserve Bank of India (RBI) shows that overseas investments by Indian companies rose by 51 per cent to US$ 3.46 billion in September 2011 from US$ 2.28 billion in August 2011. Outward investment by India companies or entities was at US$ 19 billion for the first six months of 2011-12." [2]

Foreign Exchange Regulation – Legal Steps and Procedure

These are the basic legal steps, which need to be considered while making overseas investment or acquisition:

- Reserve Bank of India (RBI) – is the Governing agency for overseas investments in India.
- Definition of Investment – Cumulative amount of exposure in
    - Equity
    - Loans
    - Guarantee

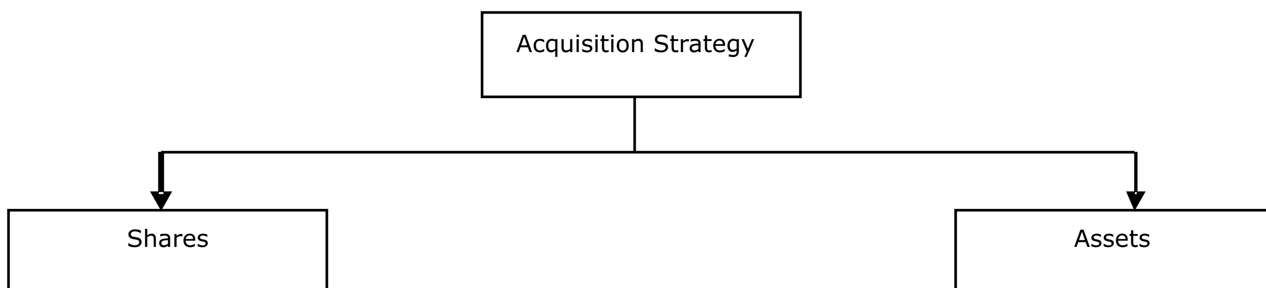
[1 & 2] *Source: Reserve Bank of India*

- ❖ Approvals are either under Automatic route or Approval by Reserve bank of India route.
- ❖ Rule of 400% of the Net worth (as per last audited balance sheet) allowed under the automatic route (subject to limitation)
- ❖ Approval route covers the following:
  - Overseas Investments above 400% of the net worth in Energy & Natural Resources
  - Investments in Overseas Unincorporated bodies, above 400% in the Oil sector. Public sector giants in Oil & Gas sector such as ONGC, Indian Oil, etc. are exempted and can proceed under the automatic route
  - Overseas Investments by Proprietary & partnerships subject to certain restrictions
  - Investments by registered trusts & societies
- ❖ Guarantee:
  - Can be issued on behalf of Wholly owned subsidiary / joint venture only if there is equity participation by Indian party
  - Can be given by Promoter Company, Group Company, Sister concern or Associate company
  - Guarantee can be Corporate or Personal, Primary or Collateral

  - No Guarantee can be open ended – amount and period of guarantee to be specified upfront
  - Limited to a overall cap of 400% of net worth

Acquisition Strategy

Following are the usual acquisition strategies which are opted for during acquisition:



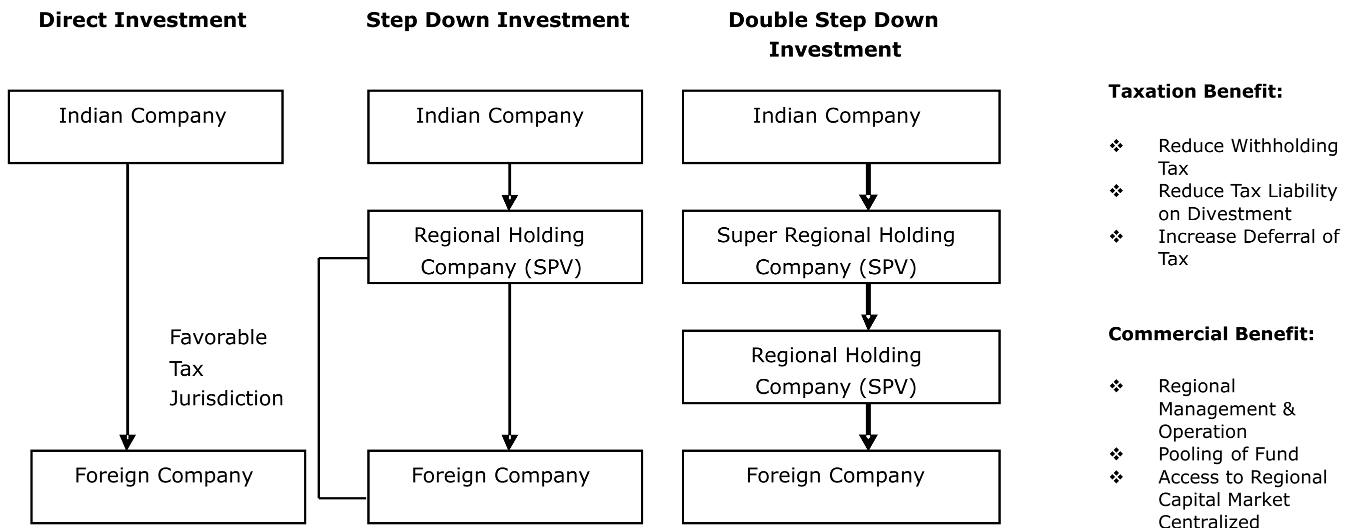
Shares

- ❖ Purchasing entire business
- ❖ Acquisition cost not reflected in financials of
- ❖ No Value Added Tax
- ❖ Consideration received by owner only

Assets

- ❖ Purchasing identified assets
- ❖ Increase Depreciation benefit to p urchaser
- ❖ Implication of Value Added Tax may possible
- ❖ Consideration payable to target company

Outbound Investment Structures



Fund Raising

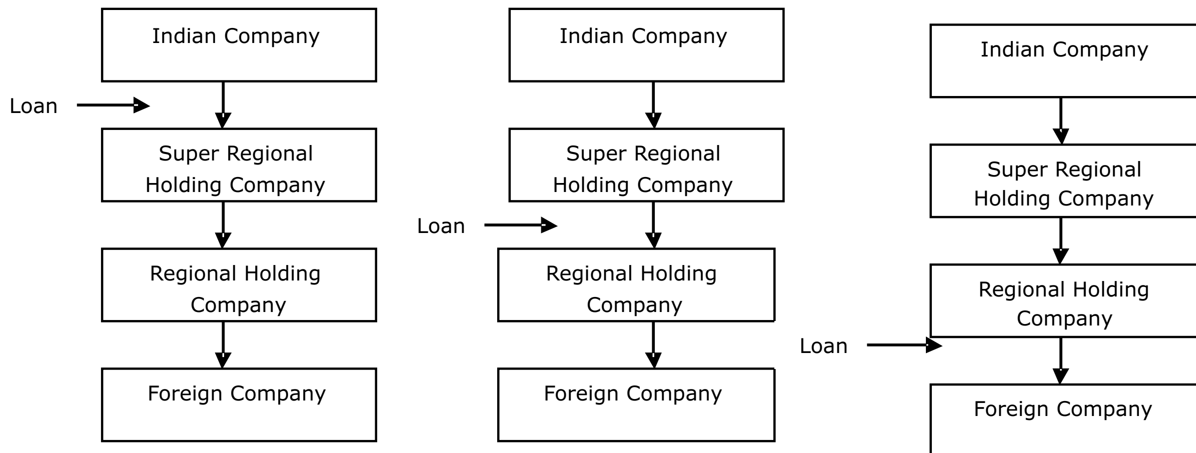
Following key factors need should be considered while opting for appropriate funding opportunities:

- Leveraging in raising funds in India and overseas
- Tax Efficient source of funds
- Maximize interest deduction
- Listing in India and Overseas
- Nil or Lower Withholding Tax
- Appropriate Pay out mechanism

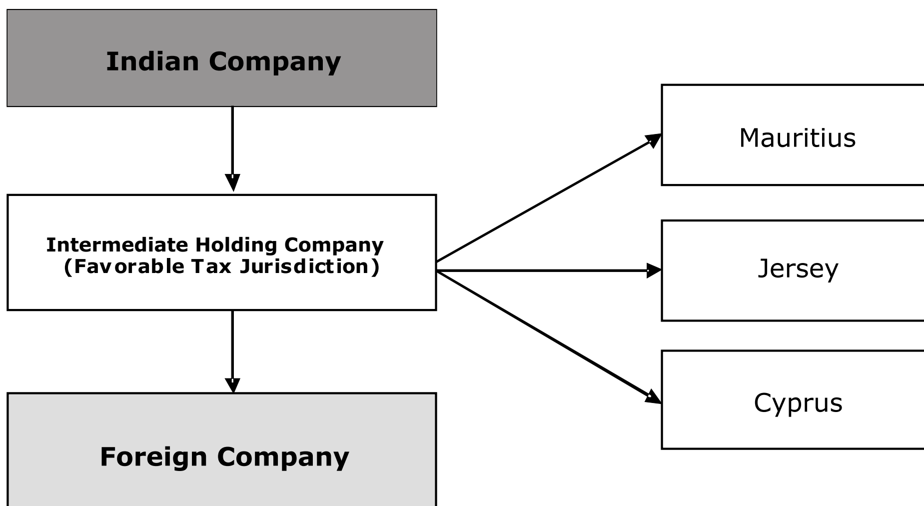
Source of Funds

- Equity infusion by Current Shareholders
- Debt from Indian Banks
- Private Equity or Qualified Institutional Placements within India (QIPs)
- Listing in India and Overseas
- Loan from Foreign Financial Institutions
- Private Equity from Foreign investors

Loan Structure



Intermediate Holding Company - Favorable Tax Jurisdiction



Income	Mauritius	Jersey	Cyprus
Capital Gain Tax	Nil	Nil	Nil
W.H.T Royalty	15% (T)/10%(D)	10% (D)	10% (T)
W.H.T Fee for Technical Services	15% (T)/10%(D)	10% (D)	15%(T)/10%(D)
W.H.T Dividend	0	0	0
W.H.T Dividend	15% (80% Credit)	0% Scheme	10%

Challenges and Precautions

❖ **Obvious Issues**

- Cultural differences & mindsets to work force, documentation & compliances.
- Immigration policies & the ability to let local management run the business
- Understanding the impact of globalization of business but using same yardsticks & management techniques used in India
- Different approach to book keeping & taxation

- Local influences such as political compulsions & relations between India & the host country

❖ **Non Obvious Issues**

- Different sets of professionals are relied upon for certain matters in foreign jurisdictions. Indian promoters are traditionally closer to their tax advisors, while most of Western world relies more closely on their legal counsel's for the operations of their businesses. Dynamics of each country is different and so Indian entrepreneurs should be ready to understand each country separately.
- Balance of power shifts from Board of directors to shareholders in each country. An expert advisor from the host country should be appointed to lead the transaction.
- In China for example, Indian businesses should realize the powers of board of advisors and not rely just upon the powers of the board.

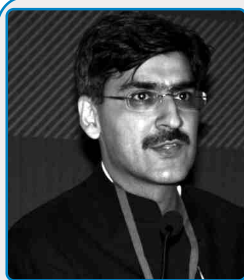
Recent developments & Conclusion

M&A	Total No. of Deals
Outbound Deals (YTD)	114
Inbound Deals (YTD)	112
Domestic Deals (YTD)	290

Source: Venture Intelligence Deal Databases

- Shareholders agreements & take-over documents should have very clearly thought out exit strategies so that in case of any change in Indian or host country's law, you are not stuck with an insoluble investment.

The sudden slide in the valuation of the Indian Rupee, along with turmoil in the international markets are likely to see a sluggish picture in the short term. However with India's long term outlook being positive and the huge Indian market to be serviced, we expect overseas acquisitions and investments to be very active in the second half of 2012 until 2015. Indian corporate bodies need to learn the benefits of global integration as soon as possible to ensure India remains an engine of growth for the world economy in the times to come.



Mr Gautam Khurana
Managing Partner
India Law Offices

Mr. Gautam Khurana, is the managing partner of India Law Offices. Mr. Khurana is specialized in foreign inward & outward investment and corporate law in India, with extensive experience in acquisitions and takeovers, corporate, project and structured financing. He is regularly called upon by foreign and domestic corporations to advise them on complex corporate and finance matters and transactions.

Mr. Khurana has passed out with B.Com (H) from the prestigious Sri Ram College of Commerce at the Delhi University and thereafter passed out from the Campus Law Centre, Main Campus, Delhi University in 1993 (the premier Law School in India). He is registered as an advocate regulated by the Bar Council of India.

He is currently on the board of many Indian companies in India, including foreign joint ventures from Italy, USA etc.

Gautam Khurana and India Law Offices have a pan India practice as well as partnerships with more than 100 foreign law firms in 14 different countries such as USA, UK, Italy, Germany, China, France, The Netherlands, Turkey, Russia, Spain etc.

Evolving Dynamics in India's M&A Landscape

Mr. Sandeep Jain
Managing Director and Head
JM Financial

Introduction

The Indian economy has witnessed rapid economic growth in the recent past with a growth rate averaging over 8% during last five years. These impressive growth numbers are also reflected in terms of the confidence of not only the Indian entrepreneur but also of the global investor in the Indian economy. M&A activity has been on the upswing ever since the turn of the millennium. The total volume of India-based M&A transactions has increased by more than 6 fold from ~US$ 5 bn in CY 2001 to ~US$ 33 bn in the year to date period(1). It is noteworthy that the cross border deals have been the major driver of M&A action during last 3 calendar years constituting more than two-thirds of the total M&A deal value.

During the current year to date period, the share of cross border activity substantially accelerated with 435 deals aggregating to over US$ 30 bn, which was over 90% of total M&A by deal value and ~ 70% in terms of number of transactions.

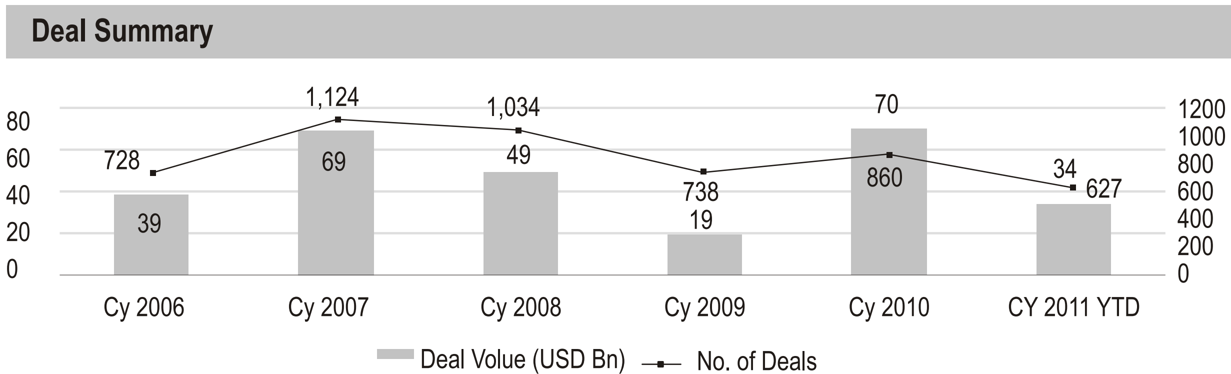
Telecom, Oil and Gas, Computers and Technology sectors dominated the M&A activity during the current year so far. We expect natural resources and technology (IT Services) sectors to continue to generate interest from an outbound perspective while consumer sector, telecom, healthcare and pharmaceuticals to see strong inbound interest. On domestic front, telecom and telecom infra sector could witness consolidation activity.

Recent Statistics and Trends in Indian M&A

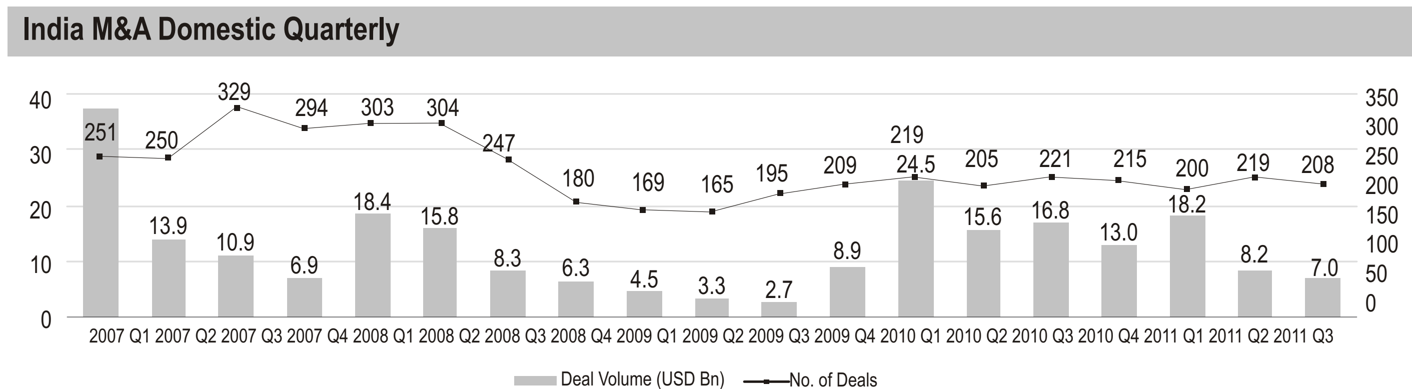
After showing a strong bounce back from lows of CY2009 during CY2010, the current year has again seen substantial slowdown in deal activity due to headwinds on global economic growth and tough financing environment. While some landmark transactions were announced in the current year such as

(1) Year to date period – January 1, 2011 to September 30, 2011

acquisition of 21 Oil and Gas Blocks in India by BP from Reliance Industries (30% Stake) for US$ 7.2 bn, Siemens AG's acquisition of Siemens India for a US$ 1.4 bn, and Cox & King's acquisition of Holidaybreak PLC for USD 727 MM among others, the volume of the transactions has reduced by 27% on a y-o-y basis.



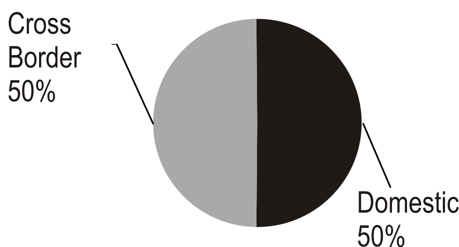
Source Bloomberg



Source Bloomberg

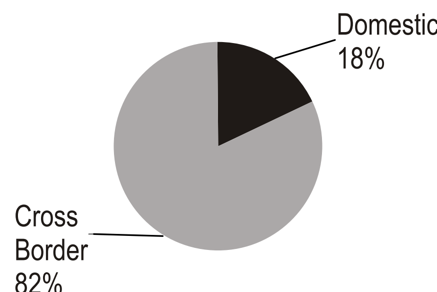
Source: Bloomberg, all announced deals (excl. terminated)

CY 2009
%



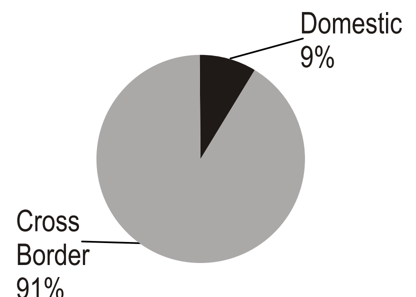
Source Bloomberg

CY 2010
%



Source Bloomberg

CY 2011 YTD
%



Source Bloomberg

The primary strategic rationale behind a number of these transactions have been:

a) **Market access:** The Indian market is expected to become the fifth largest consumer market in the world with its potential consumer base close expected to grow to 600 million by the year 2025 as per market research reports. With a strong economy, growing middle class and increasing affordability, the Indian market continues to be a focus area for a number of global players. As a result we have observed several inbound transactions to gain access to the growing Indian market such as Reckitt Benckiser's acquisition of Paras Pharmaceuticals and Danone's acquisition oWockhardt's nutrition business.

b) **Consolidation in the sector for scale:** This is another key strategy behind a number of transactions. For example, GVK Power & Infrastructure Ltd's acquisition of Bangalore International Airport, acquisition of Henkel India by Jyothy Laboratories and acquisition of Chloro Chemicals of Kanoria Chemicals by Adithya Birla Chemicals.

c) **Consolidation of holdings by companies:** This strategy has resulted in several inbound transactions during the last several quarters (such as various delisting offers and consolidation offers particularly by MNCs). During the current YTD period also, one of the largest announced transactions was for consolidation of holdings which was Siemens AG's acquisition of 19.82% stake in Siemens Ltd for USD 1.3 bn.

d) **Acquisition of strategic natural resources:** Indian corporate houses have realized the imperative of access to natural resources which are inputs to their various businesses. This has also led to many cross-border transactions such as GMR Group acquiring a 30% stake in Golden Energy Mines for USD 450m to gain access to coal assets in Indonesia. We expect the Indian corporates to be strongly inclined towards attractive natural resources companies located in resource rich countries such as Australia, Africa and Indonesia.

Key themes going forward

We believe that the following would be the key themes for M&A market during the next 6-12 months:

1) **Outbound deals:** We expect the outbound deals to accelerate for the following reasons: a) High competition in certain sectors domestically which makes it important for Indian companies to look

outward; b) Certain attractive opportunities available at reasonable valuations both in developed and developing world; c) Greater confidence of Indian companies as regards execution of such deals; and d) Ensure access to natural resources in foreign countries.

2) **Inbound deals driven by consumer sectors:** We could witness following major trends for inbound M&A deals: a) Opportunistic consolidations (stake enhancements): The MNCs will attempt to consolidate their position in the areas already present by either enhancing shareholding or doing bolt-on acquisitions; and b) most importantly, as mentioned earlier, the inbound transactions will continue to be driven by strategic imperative of global companies to get access to growth oriented Indian consumer led sectors.

3) **Continued significance of Private Equity:** Private Equity will continue to play an important role in deal making in India. The global PE giants have raised substantial emerging market focused/India focused money and still continue to have large sums of undeployed funds. The PE space has seen deals worth approximately US$ 7.2 bn during the current year, which is an increase of about 27% from the corresponding period last year. Large number of PE transactions was announced this year such as Bain Capital's investment into Hero Investments, Apollo's acquisition of Welspun, Blackstone's acquisition of Chattisgarh Power and Visa Power and KKR's investment into Avantha Power. In addition, exit attempts by PE players will result in significant deal action. We have noted that the PE players have been demonstrating greater flexibility in terms of deal sizes, sectors and percentage of stake acquired (including certain buyout deals which are emerging as an important trend).

Key sectors

We believe that the following would be the key sectors to watch out for during the next 6-12 months:

a) **Telecom and Telecom Infra:** In the past, we have witnessed some big ticket transactions in this sector. While the subscriber base in India continues to grow in excess of 10 million new subscribers per month, the sector has also witnessed severe price competition, reduced spectrum availability and falling Average Revenue per User or ARPUs. We believe the growing saturation in the market may lead to a decline in the intensity of M&A activities going forward. The focus shall now shift to consolidation within the sector with existing large players acquiring companies that have licenses to operate in smaller sectors. Focus would also shift to cross

border acquisitions especially in emerging and high growth economies like Africa, Middle East and Eastern Europe as evidenced by Bharti's acquisition of Zain's assets in Africa.

b) **IT and IT Enabled Services:** The year 2009 witnessed a slow down in terms of number of transactions in this space. The slow down in the US and UK economies that contribute a bulk of the earnings was a major reason for this. Additionally the financial crisis accentuated the slowdown in this sector given that Banking and Financial Services vertical is the largest contributor to the sector's revenue. However, in the year to date period and the current quarter this sector is has been among the top five sectors. This shows considerable revival and is expected to grow driven by both inbound and outbound interest to get scale or access to technology or customers. This sector has seen some prominent transactions during last few quarters such as Serco's acquisition of Intelenet and IGate's acquisition of Patni.

c) Consumer driven sectors: Consumer products companies in India are generally characterized with high growth, substantial free cash flows and low leverage. The M&A activities in this space is expected to be in the nature of cross border acquisitions (predominantly inbound), with foreign companies entering India to tap its growing consumer base.

Key Considerations in Indian M&A – Financing and regulatory framework

a) **Financing framework:** Debt financing for undertaking M&A transactions in India has traditionally been difficult to obtain compared to that in other developed markets. There are restrictions on domestic Banks' lending for acquisitions. The Indian banks have a limited ability to finance acquisitions directly since the acquisition financing forms part of the capital market exposure of the bank with relatively lower permitted overall limits. While the NBFCs do not face such restrictions on lending but generally do not have large balance sheets to finance large deals. Further, under the current Indian regulations, an acquirer is not allowed to raise funds by way of FCCBs or external commercial borrowings ("ECBs") to finance the acquisition of a target company. The acquirers also cannot take debt on the books of the Company to acquire the same Company's shares. Given limited avenues of financing, M&As in India have largely been financed through Company's own funds or equity funding by Promoters or through structured debt. The Indian companies, however, have greater flexibility in financing outbound deals via loans obtained through overseas banks or foreign branches of Indian banks subject to rules and regulations prescribed

under FEMA. A number of innovative financing structures have evolved and developed during the last few years for India originated outbound deals. .

b) **Regulatory framework:** M&A transactions in India are governed by a host of regulations. In summary, the key applicable regulations are:

(i) **Companies Act:** Mergers in India are required to go through a Court approved scheme of amalgamation under section 391 to section 394 of the Companies Act.

(ii) **SEBI Takeover Regulations:** Acquisition of substantial shareholding or control in Indian listed companies is governed by the Takeover code of the Securities & Exchange Board of India.

(iii) **RBI/FEMA:** The Reserve Bank of India monitors sectoral limits and governs the foreign investments in India through circulars issued by it under the powers granted by FEMA.

(iv) **FIPB:** The Foreign Investment Promotion Board approves all foreign investment coming into India through the approval route based on RBI circulars and the Press Notes issued by Department of Industrial Policy & Promotion.

(v) **Competition Act:** The Competition Commission of India is now fully functional and, the same will have significant implications with respect to the timelines of M&A activity in India.

Key recent Regulatory developments

a) **Companies Amendment Bill:** The Companies Bill that seeks to replace the current Companies Act 1956 has been awaiting clearance of Indian Parliament. Some of the key provisions in the bill with implications on M&A include movement from Court sanctioned schemes to tribunal systems for faster approvals, provisions regarding cross border mergers and squeeze out provisions for minority shareholders.

b) **SEBI Takeover code:** SEBI has amended its Takeover Code which was notified by SEBI on September 23, 2011 and is applicable for all the offers made on or after October 23, 2011. The salient changes in the current regulation (among others) are :

1. Rise in the initial trigger limit from the current 15% to 25 %. Consolidation of holdings of up to 5% per annum has been continued up to the maximum non-public shareholding limit (i.e. 75%) as against the earlier limit of 55%, potentially paving the way for larger 'growth capital' oriented transactions for funding and greater flexibility for promoters to consolidate their holdings in a Company.

2. The Offer size for a mandatory offer has been increased from the current minimum 20% of the emerging voting capital to 26% of the emerging voting capital, which will enhance the financing requirements for the acquirer, but will also result in greater opportunity to exit for minority shareholders.

3. Greater price uniformity and alignment between exiting controlling shareholders and the minority public shareholders through abolition of non-compete payment.

c) **Competition Act:** The recently promulgated act is the equivalent of anti-trust laws that exist in more developed jurisdictions. The Competition Commission of India ("CCI") is now fully functional. The merger control (or merger regulation) provisions of the Competition Act, 2002 came into effect on March 04, 2011 and effective June 01, 2011, all M&A transactions qualifying a prescribed threshold are governed by the provisions of the Competition Act. The Act covers inter-alia, combinations that have an appreciable adverse effect ("AEE") on competition. Only those combinations that satisfy the assets or turnover criteria as stated under the act come under the purview of the act and need to be compulsorily notified to the CCI. The Competition Act could significantly affect timelines for qualifying transactions. There can be cases where due to an approval pending from CCI, the companies may not be able to fulfill other statutory requirements e.g. completing the procedures as per SEBI (SAST) Regulations, or may have to incorporate modifications to the transactions as suggested by CCI.

d) **FIPB:** The latest consolidated FDI policy was released on September 30, 2011 (Circular 2 of 2011), effective October 1, 2011. The most significant change in the circular deals with treatment of equity-linked instruments; only equity shares and mandatory converts, with no in-built options of any type, would henceforth qualify as eligible instruments for FDI. All other instruments issued/transferred to non-residents would have to comply with the ECB guidelines. This would reduce the flexibility available with certain investors (esp. private equity players) from being

able to incorporate certain 'exit clauses' such as put/call options or buyback by companies to protect their downside and returns, while investing through equity-linked instruments. In view of far reaching implications of the aforesaid change (in terms of the quantum of FDI erstwhile received through this route), it is expected by market players that the department may relook at the new policy move and issue clarifications to rationalize the impact of the change in policy.

To sum up, despite current slowdown, the Indian M&A landscape promises to be action-packed, the activity may be down, but the strategic enablers of deal making remain intact and bode for a promising future.

Mr. Sandeep Jain
Managing Director and Head
JM Financial

Sandeep joined the Investment Banking Division of JM Financial in 1998. He is a Bachelor of Engineering (Mechanical) and has completed his Masters in Management Studies in Finance. In his current role he is responsible for leading execution of M&A advisory practice at JM Financial. He has a rich experience in M&A, having advised some of the leading Indian and global clients on several landmark transactions some of which are - Joint Venture between Eicher Motors and Volvo, Sale of majority stake in Sesa Goa by Mitsui, Advising Essar Group with respect to Vodafone's acquisition of Hutch Essar, Corporate restructuring of Reliance Industries, Temasek's investment in Tata Teleservices Ltd., VSNL's acquisition of Dishnet DSL, Acquisition of RMC division of L&T by Lafarge, Hive off of Sponge Iron business by Grasim to Welspun among others. Prior to joining JM Financial he has worked at Deutsche Bank.

Mergers and Acquisitions: Acquiring New Currency?

Dr. V Shunmugam
Chief Economist,
MCX Stock Exchange

Booming Indian economy coupled with crisis-led troubles for businesses in the developed economies not only made it lucrative for Indian businesses to go shopping for potential growth and diversification opportunities through mergers and acquisitions but had also made the regulators cautious about evolving new structure of businesses and its impact on economic stakeholders in India. Though as a terminology, it has not been entirely defined under any of the key regulations in India, the implications of 'mergers and acquisitions' are widely recognized and regulated through various legislations, rules and regulations in India. The newly amended Takeover Code and the recently enacted Competition Act and the coming into being the Competition Commission of India are signs that M&A is acquiring new currency among policy makers and regulators in an effort to prepare the country better cope up with the evolving new business environment. In the emerging economic and regulatory environment it would be hard for policy making to respond immediately but the onus lies on the businesses to mitigate any policy making concerns by keeping the process of their M&As transparent, regulatory-compliant at every step and making them market-friendly in all possible ways. Rather than calling these recent developments as unfriendly, the onus lies on the businesses to evaluate these regulatory requirements more carefully and respond to them in an appropriate way i.e. to look at opportunities from a long-term value addition perspective.

M&A Activity Expectations and Shifting Economic Activities – 2011

Traditionally Corporate cash reserves and PE remained the main drivers of M&A activity backed up by the prevailing interest rate, available leverage, and the overall economic performance. Corporates and PEs of foreign origin in an effort to seek greener markets have

started knocking on the doors of Asia and Pacific mainly from North Americas due to the current slowdown in their economies and the pressure on their own bottom lines. Asia in general and India and China in particular had been in the radar of the businesses and PE investors keeping in mind the robust growth in the last five years these economies have witnessed. With about 11 percent of the globally accounted for M&A deals reported in India during 2011, India had acquired an important status among the global deal makers with its economic growth being the sole driver augmented by the interest rate differential in a high inflation scenario. The other drivers for the increased M&A activity includes coming back of leverage in lending activities, willingness of banks to finance large deals, availability of more assets for sale, portfolio strengthening intentions of the PEs, accumulation of cash reserves with corporate, and the aspirations for revenue growth among corporates and PEs, expansion of customer base and geographical reach along with the low interest rate regime prevalent in most developed economies.

Unlike in the developed nations most of the activities i.e. accounting for 87 percent of the value of M&A activity that had happened so far are not only high value transactions but that belonged to mostly inbound and outbound M&A activities. PE activities in M&As account less than 10 percent in India compared with 30 percent in US and about 15 percent in China. The level of PE business activity especially in the area of M&A indicates the level of maturity of the funds industry in India and the level of maturity of the process of evolution of businesses in the economy i.e. to what extent funds industry seed business ideas, take part in their growth process and make them mature market players. In addition, the strength of PEs in M&A activity in an economy is also a function of availability of start-up firms funded by the venture capital funds posting a strong growth enough to attract PE investments. Hence, the functioning of a healthy fund industry backed up by efficient stock markets is necessary for the healthy existence of businesses complimenting economic growth. It not only subsumes increasing access of businesses to the capital markets as they growth, but also includes free and fair access of capital markets to the funds industry both for the purpose of buying and selling stakes in the businesses be it in the primary or the secondary markets but also enabling them to raise risk capital if they see opportunities to arbitrage risk capital depending

on market conditions. However, with a clear roadmap being laid out for their existence and activities providing with the passage of regulations governing their ownership, functioning and structure, providing them way forward would be a few steps away.

In the context of the big ticket M&As that have happened in India during the last few years, the regulation had responded keeping in mind the interests of the consumers of these businesses and the minority stakeholders in these firms. It is pertinent here to examine these developments in the light of emerging scenario in the financial markets both in the domestic and global contexts.

Competition Act, 2002

Economic reforms process started during 80s also marked the privatization process wherein the government moved away from businesses to be better left for the private sector to take over. This process of privatization also brought in challenges not only on how private sector did business but also how the market situation allowed them to exist healthy in a perfectly competitive environment. Policy responses to the shifting of markets from public sector dominated to a private sector dominated entity include sectoral regulations, price control, etc. Along with such regulations, Monopolies and Restrictive Trade Practices Act which controlled monopolies from evolving in the markets, hurting the consumers and feeding on inefficiency, was rendered redundant. As a result the government moved the regulatory regime from one that controlled evolution of monopolies in to one that helps create healthy competitive situation to develop in various sectors within the economy. As the current economic policies were expected to create a competitive environment for private businesses to emerge and thrive healthy making it a win-win

for both businesses and consumers, the Government of India enacted the Competition Act, 2002 to replace the existing MRTP.

Years just prior to Financial Crisis and the period after that i.e. 2005-09 saw various inbound and outbound mergers and acquisition taking place among businesses across various sectors. It was the same time when the activism among the private business regarding healthiness of the competitive environment developed leading to growing litigations. It also made the competition commission remain proactive wherein it had crafted various regulations under the Act and took up issues of public interests in a proactive manner. Section 3-6 of the Competition Act contains the provisions pertaining to M&As and a substantive part of it is being notified.

Competition Act, 2002, makes it mandatory for businesses undertaking mergers and acquisitions to give prior notice to the Competition Commission of India in a prescribed format within 30 days from the date of receipt of its approval of such combination or the execution of

any agreement or other documents for acquisition. The M&A shall become effective only after expiry of 210 days from the date on which the notice has been given to CCI or after the CCI passed an order approving or rejecting the combinations of businesses.

Critics have indicated that the mandatory 210 days of lengthy waiting period would impact the time lines for businesses to close their M&A processes and the costs involved in waiting out the mandatory timeline as indicated above. However, as the CCI develops its human resource capabilities and streamlines its internal processes this timeline is bound to get shortened and hence may remain less of a financial burden for the firms involved in M&A activities. In the meanwhile, the onus lies on the firms involved in M&As to be proactive in terms of providing them with as much information as possible to expedite the approval process.

Takeover Code, 1997

Substantial Acquisition of Shares and Takeovers Regulations, 1997, called in short as Takeover Code of SEBI governs the takeovers of

listed companies within India. This regulation is being amended from time to time to reflect the realities of corporate finance, corporate governance and ownership structure. In an effort to implement the recommendations of the Achutan Committee appointed to look into the need for changes in the act that was amended way back during 2002.

The code as implemented now attempts to provide a level playing field for takeovers by the domestic and foreign firms keeping in mind the differences in the conditions pertaining to access to finance as it exists today by not accepting the 100 percent open offer recommended by the Achutan panel. Non-availability of bank finance for the domestic firms involved in M&As domestically compared with the foreign firms would have offered them an undue advantage. Additionally, the purpose of the regulations is also to take care of interests of the minority stakeholders while firms undergo the process of takeover. The current provisions which bars the promoters from charging non-compete fee in any form is a blessing for the acquirers though rarely in the past such fee proposal could pass through the regulatory scanner as per the earlier provisions. The new regulations also provide more clarity on what could be defined as indirect acquisition and obligations in case an indirect acquisition to take place in a firm.

Despite all the criticisms, the regulators have played the role of balancing the interests of investors and the promoters keeping in mind that

entrepreneurial interests and investment interests should continue to flourish and put the economy on sustained growth path.

The New Currency to be Banked Upon:

Changes in takeover code and the regulations of the CCI are an indication that the regulations and policies have always eased the process of doing business in the country trying to walk the thin line between the interests of entrepreneurs, investors, and consumers of goods and services in our economy. In this context our ability to make the best out of the emerging economic environment and the regulatory changes would only determine if we can make the best out of the existing resources. In order to do that it is necessary that regulations evolve to strength the funds industry and improve their access to capital markets so that the country looks at M&As as an activity happening among the elites in the sector and rather happening across all sizes of businesses in various sectors. Finally, leveraging the 'population dividend' is essential for promotion of entrepreneurialism, innovation, technology development, and the existence of investor friendly regulation providing for strong protection of consumer interests. A healthy regulation of M&As in the corporate sphere would not only provide for promotion of entrepreneurial spirits among our stakeholders but also keep it healthy the investor interests besides contributing to the overall economic growth of the nation.

Dr. V Shunmugam
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Dr. V Shunmugam is the Chief Economist at MCX Stock Exchange Pvt Ltd. (MCX-SX), Mumbai. Having obtained extensive experience in economic research, commodity and currency markets and policy analysis, his key responsibility as the Head of Research at MCX-SX is to analyse market data and trends and informing market participants, regulators and policymakers about how the markets are trending and, therefore, the course that ought to be taken in line with the changing global and domestic socio-economic and political needs.

As an expert on forex and commodity markets, Dr. Shunmugam also propagates the need and benefits of hedging risks in foreign currency on the exchange platform via his articles, white paper, case studies, lectures and speeches etc, for various market participants like corporates, SMEs, importers and exporters, among others. Earlier, Dr. Shunmugam was the Chief Economist at the Multi Commodity Exchange of India Ltd. (MCX), and as the Head - Economic Analysis and Publications Division, he analysed commodity market trends, regulations and policy issues and kept the stakeholders updated about the same.

Dr. Shunmugam regularly contributes research papers, analyses, articles, etc. on subjects ranging from commodities to capital markets to issues related to trade policy, financial markets and the recent global financial crisis in national and international publications of repute, including journals, books, financial dailies and trade publications.

Prior to joining MCX, he was an Agricultural Specialist at US Department of Agriculture (USDA), where he spent more than 8 years.

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Mergers and Acquisitions in India – Regulatory Challenges

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The past several years have witnessed a slew of transactions in the mergers and acquisitions or "M&A" space across diverse sectors of the Indian economy. The Indian economic reforms since 1991 and the consequent growth have opened up a host of opportunities and challenges for corporate houses both in the domestic and the international spheres. The inherent desire and need for every business to grow vertically and horizontally has been the driving factor behind the increasing number of M&A deals in India. Alongwith the increased activity, the trends of M&A have also changed over the years and unlike in the past where the M&A activity largely constituted domestic deals, recent trends have witnessed significant cross-border action, both inbound and outbound.

In tune with the emergence of India as a global economic powerhouse, India focused M&A volume has also experienced a boom, indicating the increasing importance of India as a market for global companies. Not surprisingly, investment through cross-border M&A has emerged as a major component of FDI.

Similarly, Indian corporates, boosted by the sustained growth during the past decade, have aggressively bid for companies abroad to realize their global aspirations. While earlier the incidences of Indian companies acquiring foreign enterprises were not so common, the situation has undergone a sea change in the last decade.

This growth in M&A has also spread across the economy with diverse sectors such as oil & gas, steel, cement, automobiles, FMCG, pharmaceuticals and healthcare, and financial services seeing successful transactions. Thus, the M&A scene in India has evolved from a largely domestic market concentrated in few industries to a global reach with intensity spreading across diverse sectors of the economy.

While there are different factors that play their part in facilitating the growth in M&A, favourable governmental and regulatory policies are a key to sustaining the increased activity. It is essential to have a smooth and efficient market where the regulatory framework facilitates corporate restructuring and provides for a level playing field for all participants. While the intensity of M&A in India has increased with the progressive easing of various governmental policies, it is observed that sometimes there is a mismatch between the fast growing M&A activity and the evolving regulatory framework governing it.

In India, M&A is governed by a host of regulations pertaining to diverse issues such as acquisitions in listed companies, FDI, competition, financing, taxation among others, some of which have seen significant developments in the recent past that are likely to affect the M&A dynamics in India. Some of the important legal aspects relating to M&A and the related concerns are discussed below.

1. SEBI Takeover Code

One of the biggest reforms affecting the M&A scenario in India has been the introduction of the new Takeover Code for listed companies by SEBI in 2011. The new Code, with its calibrated approach towards all stakeholders, is a positive step which is likely to boost M&A activity in India.

In one of the most far reaching reforms, the initial threshold for triggering the open offer has been increased from 15% to 25%. This rationalization of the trigger point was long overdue and is expected to significantly increase fund raising options for listed companies. The earlier threshold of 15% severely restricted the ability of listed companies to attract any sizeable private equity or strategic investments for fear of triggering the open offer. The revision of the threshold to make it more accommodating is in tune

with the market dynamics and make listed companies more exciting for acquisition of substantial stakes. Going forward, we are likely to see a sizeable growth in both the number and the volume of private equity deals in listed companies, especially in the small and mid-cap segments.

Along with the threshold, the timeline for execution also plays a key role in M&A. The new Code has streamlined the schedule of activities and shortened the timeframe for completion of the open offer and all associated formalities, thus bringing greater efficiency in execution.

However, in spite of the laudable simplification and streamlining of a complicated law, concerns remain on issues like abolition of non-compete fee and disallowing of automatic delisting. While the new Code seeks to establish parity amongst all shareholders,

outright scrapping of the non-compete fee may not be a sound move, especially in cases where the promoters have made a real contribution to the business. The fact remains that very often shareholders with a substantial stake in the business also have a significant impact in terms of innovation, managerial expertise, knowhow, etc. and a non-compete fee or control premium is recognition of this reality.

Similarly, the non-inclusion of a provision for automatic delisting may act as a dampener for acquirers looking to go private. While the Achuthan Committee had recommended the inclusion of a provision for automatic delisting subject to a threshold, SEBI has not accepted the same and in fact, the new Code makes it impossible for the acquirer to delist the company where the acquirer's shareholding exceeds 75%. This move is not in tune with the market dynamics where many acquisitions, especially inbound ones, have an underlying intention of delisting.

2. Competition Act

Another important development on the regulatory side has been the notification of the provisions of the Competition Act relating to M&A. After lapse of 20 years since the opening of the Indian economy in 1991, the time is ripe enough for the regulation of dominant positions and huge combinations achieved through M&A. While the Competition Act is a laudable attempt at regulating anti-competitive practices in line with international practices, concerns remain on certain issues such as the low thresholds, timing of mandatory notification and stretched timeframes in the context of M&A.

While only combinations with a significant Indian nexus are sought to be regulated, the current thresholds appear to be on the lower side, even after the recent revision. Thus, it can potentially bring a large number

of M&A deals with no adverse impact on competition within the ambit of the Competition Act, and the consequent burdensome notification requirements. There definitely exists a scope for further increasing the thresholds. Additionally, it is imperative that the thresholds be adjusted for inflation on a periodic basis to avoid inadvertent narrowing over time.

There is also a lack of clarity as regards the triggering of the mandatory notification, with the Act imposing the obligation to make a notification on execution of any agreement for acquisition, whether binding or not. This requirement imposes an unnecessary burden on potential acquirers as even preliminary non-binding term sheets, or even confidentiality agreements at the extreme, would also trigger the notification. Further, it may happen that several potential acquirers have to file notifications for the acquisition of the same target. Accordingly, the requirement of notification requires rationalization to the extent that it should be linked to definitive or enforceable agreements.

Along with the confusion surrounding the timing of the

notification, the Act also imposes a post-notification waiting period of up to 210 days, which is not in line with international best practices. Since time is of the essence in any acquisition, the stretched timeline is a major dampener in the execution of an M&A deal and requires trimming to create a more conducive market. Further, the timeframe specified by the Act is not in harmony with the provisions of the SEBI Takeover Code and it may so happen that acquirers may have to bear the unnecessary burden of paying interest to the shareholders in the open offer due to delay in obtaining approval from the Competition Commission.

3. Foreign Direct Investment

The FDI regime has seen continuous evolution towards a more liberal and investor friendly policy framework. The high level of FDI inflows into India are as much an affirmation of favourable governmental policies as of the future economic potential of India. However, the policy framework can be further smoothened to provide for automatic approval up to 100% ownership in all sectors except those which specifically need to be regulated.

Apart from inbound FDI, the decade 2000-2010 has also seen several Indian companies acquiring assets abroad. In fact, in the latter half of the decade, several Indian corporates have acquired companies far larger than themselves in offshore jurisdictions. As regards promotion of outward FDI, the introduction of the Foreign Exchange Management Act in 2000 saw the beginning of liberalization of the policies on Indian investments abroad.

Currently, the Reserve Bank of India allows corporate entities to invest in bona fide businesses abroad to the extent of 400% of their net worth under the automatic route. Keeping in view the growing sizes, competitiveness and appetite of Indian corporates, this limit may require review and consequent increase. Furthermore, approval from RBI is required for sale/disinvestment of overseas Joint Venture/Wholly Owned Subsidiary at a loss. However, sale or closure of overseas entities for genuine business purposes should be allowed under the automatic route.

4. Restrictions on Financing

One of the most important drivers of M&A in any market is the availability of funds. However, Indian corporates are faced with domestic legal and regulatory hurdles on arrangement of finance while embarking on any acquisition strategy. Indian regulations impose restrictions on the ability of banks in India in relation to acquisition financing, prohibiting them from lending to a borrower.

The existing RBI guidelines prohibit Indian banks from providing loans against the security of shares for the purposes of acquiring companies in India, and the Companies Act 1956 prohibits the provision of financial assistance by any public company (whether listed or unlisted) to any person for the purposes of purchasing the shares

of that public company. These provisions render the execution of leveraged buy-outs in India very difficult.

The degree of exposure to capital markets of a bank in India is also subject to stringent limits. Moreover, under the extant legal framework of RBI relating to exchange control, foreign currency loans, including the proceeds of foreign currency convertible bonds and external commercial borrowings (ECBs) cannot be availed of for the purposes of domestic acquisitions. Although ECBs could be utilized for the acquisition of offshore companies, various restrictions, including the all-in-cost ceilings and the cap on interest rates, make it difficult for many Indian companies to resort to such sources of acquisition financing.

Therefore, Indian companies resort to borrowing from non-banking financial companies (NBFCs), which have no limit on capital market exposure and can take security in the form of pledge of shares of Indian companies. However, systemically important NBFCs are required to maintain a capital adequacy ratio and are also subject to counterparty exposure norms due to which

they do not have the balance sheet size to undertake big ticket transactions.

These hurdles render the execution of leveraged buy-outs by Indian companies, in India or abroad, very difficult. Compared to the relatively easier financing available to foreign companies, Indian companies are faced with stiff competition in execution of any acquisition. Accordingly, the regulatory framework on bank financing of acquisitions needs to be reviewed to provide Indian acquirers with a level playing field against their foreign counterparts.

5. Key Taxation Issues

While M&A deals provide unique tax planning opportunities, they are also fraught with potential tax risks. In this context, it becomes necessary that taxation laws should develop side by side with the M&A environment and provide for clarity required to adequately assess tax liabilities. The lack of clarity, as observed in the case of Vodafone, is likely to have an adverse impact on future cross-border M&A. Thus, there is an overwhelming need for simplification of taxation provisions affecting M&A.

Apart from simplification, there are also other taxation issues associated with M&A activity in India that impose tax burdens and require consideration. It is a fact that many M&A deals involve a non-compete fee, which is the control premium paid for the real contribution made by the existing promoters. However, the same is not specifically included in depreciable intangible assets, which results in denial of tax benefits on genuine acquisition costs.

In the case of M&A structured as earn-out based transactions, the consideration for the acquisitions is linked to future profitability of the business. However, in such transactions, taxes are charged upfront leading to cash flow mismatches.

Another key issue that needs to be addressed is the taxation imposed on transfer of shares of unlisted companies at nil value or less than fair market value as

recipient's income. M&A deals often require genuine business re-organization, which involves realignment of assets within the group to achieve greater efficiency. Subjecting such genuine transactions to tax imposes an unnecessary burden and discourages potential acquirers.

In Conclusion

The tremendous increase in M&A in India is without doubt linked as much to the evolution of an accommodating policy environment as the growth story. Policy initiatives to make India a more attractive market for M&A have been successful as evidenced from the numbers. However, the pace of growth of the M&A market and its impact on FDI and consequent economic growth requires policymakers to be more proactive and respond more effectively to industry concerns to sustain the growth.

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Prior to founding o3 Capital, Shiraz was with Avendus Advisors and Rochem-India. At Avendus, he led the life sciences practice and focused on emerging life sciences sectors including custom synthesis, diagnostic services and CROs.

Shiraz received a B.E. degree from Mumbai University and an M.B.A. from Melbourne Business School. He has been instrumental in the development of o3 Capital's investment banking activities in India and the U.S.

Under his leadership, the firm has advised on marquee transactions such as acquisition of German automotive components manufacturer Peguform GmbH by Indian firm Motherson Sumi Systems Ltd, acquisition of an Indian nutraceutical business by French pharmaceutical firm Sanofi and investment by Warburg Pincus into the Indian diagnostic chain Metropolis Healthcare.

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M&A in India-Potential destination for Investors

Robin Roy, Associate Director,
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India's growth story in the last few years has evinced tremendous interest amongst foreign investors who want to invest in India to capture strong consumer services market. The surge in demand for both corporate and consumer financial services are attracting ever greater interest from international groups. Niche growth markets such as private banking and acquisition finance, have offered a point of entry for a number of leading international groups. However, regulatory concern and policy issues have often become an inhibitor for foreign investors looking at the acquisition route to enter India.

It must be said that with the liberalization in the'90s, successive governments have taken initiatives to encourage foreign investment which has contributed to increasing global interest in India. Several corporates in India have also succeeded in significant acquisitions abroad, Tata Steel acquiring Corus, Tata Motors acquiring Jaguar, Bharti acquiring Zain Telecom and Hindalco acquiring Novelis to name a few. However, in the financial services domain, Indian firms are yet able to gain a strong foothold in the global markets in terms of acquisitions, despite attractive valuations.

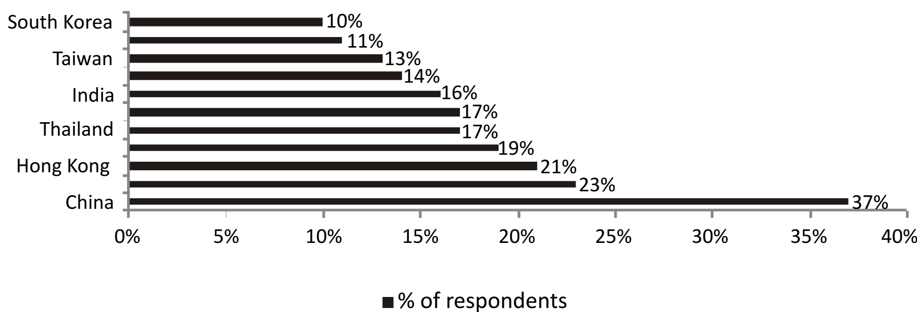
The M&A space in India can be seen as a mix of two themes: "Consolidation & Opportunity Seek". In the financial services, alliances with global players can give the benefit of global opportunities in funds' mobilization, credit disbursal, investments and rendering of financial services, can also lower intermediation cost and increase reach to underserved segments for banks. The global players of the developed economies are seeking to enter India as their markets stagnate and India provides a great opportunity with

growing demand from the middle class, a much higher saving rates and lower financial penetration levels across the population.

M&A volume in India surged three-fold to $67.2 billion in 2010, from $21.3 billion the previous year, with $2.1 bn in financial services from$ 718 m in 2009. India's M&A market is marked by a string of joint ventures (JVs) between Indian and foreign businesses, outright acquisitions by domestic and foreign players and small number of PE investments.

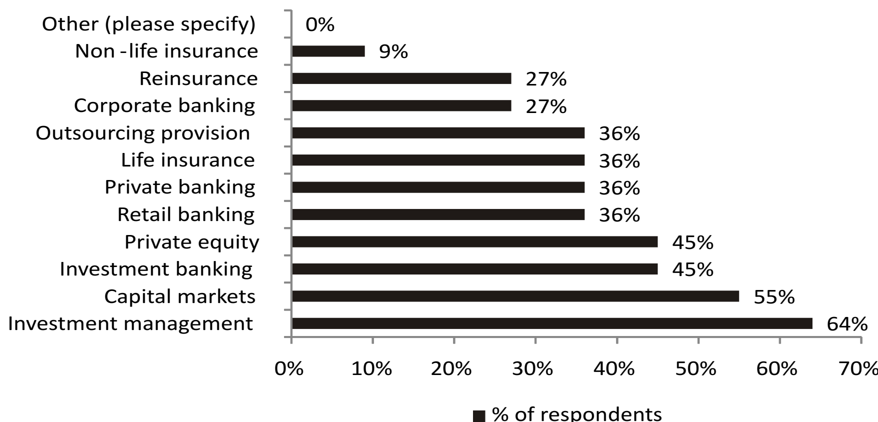
The PwC Survey titled 'Financial Services M&A in Asia 2011" shows that despite the huge potential that the Indian financial sector holds, only 16% of the respondents identifies it as a potential destination for geographic expansion vis-à-vis 37% for China and 23% for Singapore. The survey also showed Investment management as the most attractive business line to develop through M&A. We believe that the M&A potential in India is still tremendous with regulators like SEBI forming new takeover laws acting as a facilitator and government is showing keenness for allowing policy flexibility to attract more FDI. Growing demand from the middle class in the country, high saving rate and poor financial penetration across the population will remain key drivers for attracting high levels of M&A in India.

Most attractive areas for geographic expansion via M&A



Source: PwC Financial Services M&A in Asia Survey 2011.

Major Attractive Business lines in FS



Source: PwC Financial Services M&A in Asia Survey 2011.

Key drivers for M&A in India

In India, while organic growth has remained in focus with substantial consumer demand, however inorganic growth in the form of M&A (particularly acquisition) has seen increased interest as an effective strategy to expand quickly to address untapped customers and new markets. Our survey shows that domestic competition is increasingly becoming a motivating factor for M&A. Some key factors that will drive M&A in the Indian financial services market are :

- Increase Market share and business growth
- Focus on geographical expansion
- Strategic interest and synergy- Firms with complementary business interests
- Improving customer experience through enhanced/new products
- Increase shareholder value
- Regulatory Intervention-RBI in the past has taken steps to bless a merger/takeover of a distressed bank to protect its depositors, and prevent any systemic risks due to de-stabilisation of the financial services sector
- Our earlier surveys have also shown that M&A deals are done primarily to build revenue and market position, by gaining access to new markets, new products and a bigger share of market. However, many a time deal makers seek to realize revenue goals but down play cost saving targets

As another economic crisis looms on the horizon, firms will take a cautious approach and the focus would remain on how to derive and sustain value from the deal. There will be significant due diligence and firms will be looking to strengthen their existing capabilities.

Key challenges to M&A in India

Our survey indicates that while lack of policy clarity and regulatory compliance are dissuading factors, lack of attractive targets and hyped up valuation remains key issues. In financial services particularly, Regulatory changes and the wait for new banking and insurance guidelines are creating uncertainty over target valuations. Regulations on overseas borrowings by Indian entities and restriction on use of borrowings for the purpose of financing domestic acquisitions, has become one of the key constraint on the growth of M&A in India.

The ongoing economic crisis will also have a bearing on the M&A's in India. Interest levels are at its peak. And financing will remain a challenge for all players, as a result of which firms may defer acquisitions and chose to strengthen their existing resources. Proposed changes to the composition of capital and

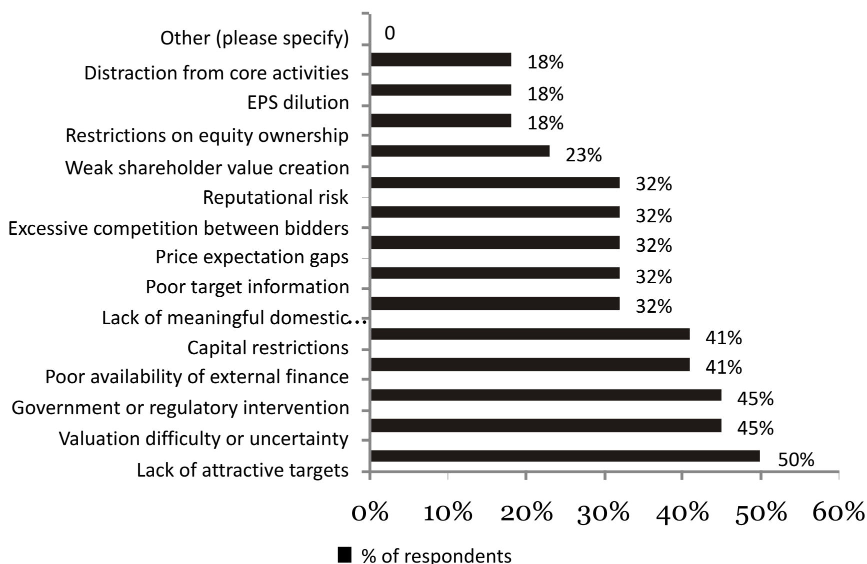
risk coverage at banks (Basel III) will lead to acquirers preferring targets with high capital and liquidity positions, and such criteria will guide M&A decisions moving forward.

The strategic acquirers will also adopt for a wait & watch approach, focusing only on deals which had a compelling investment proposition. The focus will be on building competitive advantages, improve core competencies and gaining foothold in a new market and this may need to look beyond financial metrics. Also, the risk levels have become higher with political risks increasing, and no tested systemic framework to address all other risks which include lack of adequate credit enhancement mechanisms, risk of supplies in input raw materials.

However, as high debt levels, volatility in capital markets and northward interest rates hurt the local companies, there could be more interest to sell off or partner with strategic acquirers.

Our Survey also shows that one of the key issues that poses a challenge post M&A is divergent management philosophies covering people, organizational culture and integration of IT systems. We believe that the Indian firms have moved up the learning curve in terms of post merger integration and this will help them ward off challenges in M&A in the future.

Principle Obstacles to Undertaking M&A



Source: PwC Financial Services M&A in Asia Survey 2011.

M&A in the Indian Financial Services sector- The changing dynamics

The Indian financial services sector has witnessed tremendous growth in the last few years driven by the economic boom, with commercial banks leading the way. The potential for further growth still remains strong as financial penetration remains relatively low compared to peers in the emerging markets and way behind the developed ones. Yet M&A activity in India is still to pick up as regulatory uncertainties, makes the financial services sector less lucrative compared to China & Singapore. The dynamics of the M&A activity in Financial Services in India hinges on the several awaited key policy and regulatory decisions, particularly, in the Banking and Insurance

domain. If we take a closer look at the sub-sectors, some key factors emerge that could change the financial sector landscape in India.

Banking: Growth has been tremendous in the last five years (CAGR of 20%) and consolidation may become a major driver as large banks in India compete with their global peers, on comparatively smaller balance sheet size There is significant opportunity for acquisition of smaller banks by the larger counterparts, Extant regulations like a 10% voting 'rights' cap and a foreign ownership limit of 5%, have also been a deterrent for M&A in India. Currently, the sector is waiting for the final guidelines on New Bank licenses, which may act as a catalyst for changing the dynamics of M&A in the banking sector as large corporate may like to acquire small banks and NBFCs to gain a foothold in an already competitive sector.

NBFC sector-Comparatively, the regulations in the Non-bank financial Companies (NBFC) sector are far less stringent than their banking counterparts (Foreign holding up to 100% is permissible) and that has encouraged investors to look at the NBFC route to enter India. NBFCs are able to conduct lending in fast-growing areas, such as mortgages, credit cards and rural lending, without the stringent regulations of the banking sector, which provides a strong impetus to deal making in this sector. The scope for regulatory arbitrage exists as there are caps on capital market exposures and lending restrictions to single entity for banks. This has led to activities like funding a promoter, raising stake through creeping acquisition, buying out partners through the NBFC route, in the recent times being used.

Till now, MNC banks and international financial services groups have entered the non-banking finance space in India by floating wholly-owned subsidiaries, however recently a string of private equity players including the large fixed income player Ashmore group of UK, private equity fund Ever stone and Goldman Sachs, joined hands for the first time to form a NBFC in India. PEs are setting up NBFCs for getting into debt which provide gap funding, promoter funding, bridge funding, even at times helping rollover of their (Corporate) loans in commercial banks, as part of Corporate Debt Restructuring. Even otherwise, PEs have been keen to investing in

NBFCs which have created niche for themselves such as Sriram Transport Finance, Mannapuram Finance etc. However, recent guidelines on tighter provisioning rules and capital requirements can act as an obstacle in the short term. But this could encourage NBFCs to seek a strategic partner in the medium term. A number of NBFCs might welcome a foreign partner that could introduce additional capital as well as technical expertise.

Insurance: The insurance industry in India is poised for higher growth as penetration still remains relatively low compared to developed economies. India's market is currently dominated by public sector companies (both life & non-life) and most private firms already have foreign joint-venture partners. Deal prospects will depend on anticipated new M&A and IPO guidelines from the

Insurance Regulatory and Development Authority, which could open up new opportunities for foreign players. Also FDI regulations restricting the foreign shareholding to 26% is becoming a deterrent.

Asset Management and Securities Market: The India's retail asset management sector has seen explosive growth over the last decade, during which assets under management (Aim), increased by seven times. Recent regulatory changes have effected distribution, but the increasing wealth of India's middle classes should generate sustained growth in demand and increasing scope for more sophisticated wealth management. The asset management sector is fragmented, with good scope for consolidation and no limits on foreign ownership. There is also increasing interest in asset management among Indian financial firms looking to offer their customers a broader range of products, as illustrated by our survey.

Lastly, India's **securities brokerage sector** has potential for consolidation. The sector is fragmented, and levels of commissions have fallen since the global financial crisis. The share of the top 10 brokers is only around 20% of the total industry revenues as the industry consolidates. The weak operating environment will provide an opportunity for acquisition and consolidation as small players may find difficult to sustain profitability. The Axis-Enam deal demonstrates that domestic players including banks would like to have a significant participation in deal activity.

Impact of new regulations on M&A

The recent proposed takeover guidelines by SEBI can have a positive impact on M&A activity. The new guidelines state that investors can raise their holdings in companies to as much as 25 percent, without having to offer to buy additional shares from the public. PE investors will be keener now as this will increase the head room for those, who would be looking at certain minimum investment in a listed company (without triggering the open offer). This augurs well for companies in their ability to raise more capital from the private equity market as this enables the Indian promoters to continue to hold majority holding.   The Competition Commission of India has also set out new guidelines for M&As which states all M&As with a combined turnover of more than Rs4,500 crore ($1 billion), or combined assets of Rs1,500 crore, would require the CCI's prior approval. However, transactions such as acquisition of stock in trade, assets or

investment in the ordinary course of business, and bonus issues or stock split are exempted from seeking the CCI nod. This will lead to protection of consumer interest. SEBI's new takeover code would help to create a healthier M&A market in India.

Future of M&A in the financial services domain in India

The M&A activity in the Indian financial services sector is expected to pick up as regulatory barriers fall. The continuous growth in Indian corporate sector and other segments will provide further boost for M&As. Banks also need to keep pace with the growing industrial and agricultural sectors to serve them effectively. The investors will also try to leverage the global platform as India's fortunes become more integrated with the global economy. There is a strong business case for such structured lending, based on local needs and as a part of a larger Financial Ecosystem. Interestingly many such new outfits are headed by ex Bankers, who bring in a good understanding of types of corporate exposures and know ways to create secured debt exposures. With time, these types of NBFCs will gather pace. Looking ahead, we may say, in the future, financial services in India will become more integrated and these will fast track the activity in the deal space.

Conclusion: The current state of global economy does not arouse lot of confidence and this time, India is no longer insulated. Also, international players (other than few cash rich ones who make seek this opportunity to enter new markets such as India at lower valuations) will try and focus on managing their businesses in existing geographies, rather than entering untested waters. Deal activity will slow down in the near future as market volatility and uncertainty will lead to valuation issues. However in the middle to longer term as the government takes steps to reduce uncertainty in policy and regulatory contours become clearer, India could see heightened activity in M&A particularly in Financial Services

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Robin is an Associate Director in the Financial Services practice of PwC. His experience encompasses a broad range of financial services segments like banking, asset management and insurance. His core experience is in Corporate, SME, Consumer & multi channel banking models. He has been involved in a number of banking related projects at PwC covering strategy and process improvement areas.

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He has authored several articles in leading newspaper and magazines in India.

INDIAN ECONOMY – AN UPDATE

Box1. Key Facts

- The projected GDP growth in FY 2011-12 has been revised downward to 7.6 per cent from 8.0 per cent by the RBI.
- Inflation continues to be the dominant concern which has impacted business confidence. With WPI based inflation standing high at 9.7 per cent in October 2011.
- The moderation in industrial growth has become more evident with the IIP growth slowing to 2-year low at 1.9 per cent in September 2011.
- In its September update of the World Economic Outlook, the IMF lowered its global growth projection for 2011 & 2012 to 4.0 per cent, down from 4.3 and 4.5 per cent respectively.

Economic Scenario

Signs of slowdown in economic activity have begun to materialize. Indian economy grew at 6.9 per cent in Q2 FY 2011-12, its weakest pace in more than two years. This reveals the heavy toll that persistent high inflation, rising interest rates and crisis-hit global capital markets are having on growth prospects.

GDP growth showed signals of some moderation during H1 FY 2011-12 with fear of significant growth deceleration in remaining half of the current fiscal. For the first half, the GDP growth rate has declined to 7.3 per cent as compared to 8.6 per cent registered in the corresponding period last year. Signs of moderation were visible from deceleration in IIP growth in April-September, poor performance of certain core industries and deceleration in sales of cement, steel and automobiles sectors.

RBI and PMEAC have forecast a slowdown in economic growth. Both IMF and ADB have also projected a moderation in the growth prospects for the Indian economy on account of base effects and policy tightening.

Commenting on the estimates of real GDP growth rate for Q2 of 2011-12, Dr. Rajiv Kumar, Secretary General, FICCI said "Even this growth rate has been achieved by significant downward revision in the GDP growth rate of Q2 of 2010-11 from the earlier 8.9% to 8.4%. This has helped the growth rate in Q2 of 2011-12 to 6.9%".

FICCI analysis shows that growth in Q2 of 2011-12 would have been lower at 6.4% without

this downward data revision of the corresponding quarter of the previous year.

Dr. Kumar also said "If the current trends are any indication, FICCI estimates that the GDP growth in the current fiscal will now be in the range of 7% - 7.1% with significant downside risks. In fact, given that the first half growth rate has been 7.3%, it is now amply clear that even the 7.6% forecast by RBI for 2011-12 is clearly on the higher side".

Of late, the transmission of monetary tightening by RBI has been fairly strong. With banks passing on the burden, the industry is faced with an upsurge in cost of capital. The industrial activity has begun to feel the impact of hardening interest rates, which is likely to choke growth further.

In the Monetary Policy review for the second quarter of FY 2011-12, the RBI hiked the key policy rate i.e. repo for 13th time since March 2010 while also lowering the GDP growth projection for FY 2011-12 from 8 per cent to 7.6 per cent.

Inflation

Inflation continues to be the dominant macroeconomic concern. Upward revision in prices of petroleum products, significant increase in the minimum support prices for some agricultural commodities and persistent high level of non-food manufactured product prices have prevented inflation from easing.

Evolving dynamics in the headline inflation suggests generalization of inflationary pressure, which has led to WPI inflation becoming broad-based across categories. Inflation rate for non-food manufactured products (Core Inflation) has reached 7.6 per cent in October 2011.

The global commodity prices and domestic demand supply gap in several commodities have exerted upward pressures on inflation in the recent past. Despite the repeated increase in key policy rates, inflation continues to be much above the comfort level of RBI.

As admitted by the RBI in its review of monetary policy for the second quarter, WPI inflation has remained stubbornly high during the financial year so far, averaging 9.6 per cent. Inflation has been broad-based, and driven by all the three major groups, viz., primary articles; fuel and power; and manufactured products.

Going forward, the inflation path will be shaped by both demand and supply factors on -

- First, it will depend on the extent of moderation in aggregate demand. Some signs of demand moderation are evident, although the impact is being felt more on the investment side.
- Second, the behaviour of crude prices will be a crucial factor in shaping the outlook of domestic inflation in the near future. The benefit of a decline in global crude prices in the recent period has been more than offset by the depreciation of the rupee in nominal terms. Thus, the exchange rate will also have some impact on the behaviour of domestic petroleum prices.
- Third, the inflation outlook will also depend on the supply response in respect of those commodities characterized by structural imbalances, particularly protein items.
- Finally, there is still an element of suppressed inflation in the economy. Domestic prices of administered petroleum do not reflect the full pass-through of global commodity prices. Prices of coal and a few other commodities do not reflect the current market conditions. As and when price adjustments take place, they will add to inflationary pressures.

Performance of IIP

Industrial growth as measured by the Index of Industrial Production (IIP) with the new base year 2004-05 for the first half of the fiscal averaged 5.0 per cent, compared to 8.2 per cent in the same period last year.

The moderation in industrial growth has become more evident with the IIP growth slowing to 2-year low at 1.9 per cent in September 2011. The eight core infrastructure industries also witnessed significant deceleration growing slowest in 30 months at 2.3 per cent.

What concerns the most is the declining trend in manufacturing sector growth. Average growth in the manufacturing sector for H1 FY 2011-12 slowed down to 5.4 per cent as against 8.8 per cent in the corresponding period last year.

The slowdown in industrial growth is all pervasive, with both investment demand (capital goods growth at a measly 4.6 per cent during April-September 2011 vis-à-vis 16.4 per cent in the like period previous year) and consumer demand (consumer durables goods growth at 5.2 per cent during April- September 2011 vis-à-vis 15.9 per cent in the like period previous year) being hit. This indicates weakening of both investment and private consumption which would impact the aggregate demand in the domestic economy.

Liquidity position & Financial Markets

In Q2 FY 2011-12, liquidity conditions continued to remain in deficit mode, in line with the policy objective of the Reserve Bank. The average LAF injection, which was around Rs 49,000 crore in the first quarter of 2011-12, dropped marginally to around Rs 47,000 crore in the second quarter of 2011-12. Liquidity deficit largely remained within (+/-) 1 per cent of NDTL of the banks, in line with the stated policy objective of the Reserve Bank.

Since the beginning of the fiscal, financial markets have seen turbulent times which are reflected in firming up of interest rate in the debt markets and consistent month-on-month decline for the equity markets. The global economic scenario has played a role in upsetting the sentiments aggravated by concerns on domestic economic slowdown.

The downgrade of US sovereign debt rating by S&P and deteriorating sovereign debt problems in the euro area resulted in renewed volatility in global financial markets during Q2 of 2011-12. On the domestic front, Indian equity and foreign exchange markets, unlike the debt and money markets, showed greater volatility in Q2 of 2011-12 than in the previous quarter. This mainly reflected risk aversion arising out of the deepening euro area sovereign debt crisis.

Going forward, domestic growth and inflation outlook, resilience of the banking sector and the nature and depth of global uncertainty will shape the developments in the financial markets. The global markets will primarily track the international policy actions to address the problem of euro area sovereign debt crisis and slowdown in advanced economies.

Table1: Key Indicators of Financial markets

	Jun'11	Jul'11	Aug'11	Sep'11
Call Rate* (per cent)	7.38	7.51	7.97	8.11
Market Repo Rate (Non-RBI) (per cent)	7.30	7.53	7.95	8.04
G-Sec 10-year yield (per cent)	8.28	8.34	8.32	8.35
Exchange Rate (INR/US $)	44.85	44.42	45.28	47.64
CNX Nifty **	5473	5597	5077	5016
BSE Sensex **	18229	18616	16888	16695

Notes:*: Average of daily weighted call money rates
**: Average of daily closing indices

Source: Reserve Bank of India

Balance of Payments

Despite a surge in exports and higher net invisibles receipts, the current account deficit (CAD) increased during Q1 of 2011-12 reflecting strong import growth on account of higher oil prices and sharp increase in imports of gold & silver, machinery and electronics. The composition of capital inflows shifted with a sharp fall in FII inflows and rise in FDI.

With economic growth slowing down, challenges stand abound on the capital inflows front. So far in 2011-12, capital inflows have exhibited an uptrend, mainly on account of robust FDI inflows and rise in external commercial borrowings (ECBs) and trade credit. However, net FII inflows have not only been volatile but also significantly low.

Going forward, capital flows into India will depend on how the economic and financial conditions in advanced economies, particularly the US and the euro area, evolve during the second half and whether relative growth and interest rate differential would suffice to outweigh the general risk perception among foreign investors.

On the external trade side, although merchandise export growth outpaced import growth, CAD surged during Q1 of 2011-12 in absolute terms. In line with the concerns raised on the sustainability of robust export growth rates witnessed in first quarter of the current fiscal, growth in India's merchandise trade slowed down for the third consecutive month in October 2011.

Table2: External Sector Performance

BoP (US $ Billion)	2010-11P	2010-11 Q4PR	2011-12 Q1P
Exports	182.2	77.2	80.6
Imports	300.6	107.1	116.1
Trade Balance (1-2)	**-118.4**	**-29.9**	**-35.5**
Current Account Balance	**-38.4**	**-5.4**	**-14.2**
Net Capital Account	53.4	8.2	20.9
Overall Balance	**13.4**	**2.0**	**5.4**
Forex Reserves in US $ Billion (as on November 18, 2011)			**308.6**
PR: Partially Revised; P: Provisional			

Source: Reserve Bank of India

Banking Sector

RBI Second Quarter Review of Monetary policy

The RB announced the following changes in the monetary policy in its second quarter review of FY 2011-12:

- Increase in the policy repo rate under the liquidity adjustment facility (LAF) by 25 basis points. The **repo rate** will accordingly move up from **8.25 per cent** to 8.5 per cent.
- Consequently, the **reverse repo rate** under the LAF, determined with a spread of 100 basis point below the repo rate, automatically adjusts to **7.5 per cent.**
- Similarly, the **Marginal Standing Facility (MSF) rate**, determined with a spread of 100 bps above the repo rate, stands recalibrated at **9.5 per cent**.
- **GDP growth projection** was revised downwards from 8 per cent to **7.6 per cent** for 2011-12

However, the **Headline inflation** projection for March 2012 is kept unchanged at **7 per cent** YoY.

Deregulation of Savings Bank Deposit Interest Rate:

On the developmental and regulatory policies, the RBI in its second quarter review also decided to deregulate the savings bank deposit interest rate with immediate effect; banks are free to determine their savings bank deposit interest rate, subject to the following two conditions:

- First, each bank will have to offer a uniform interest rate on savings bank deposits up to Rs 1 lakh, irrespective of the amount in the account within this limit.
- Second, for savings bank deposits over Rs 1 lakh, a bank may provide differential rates of interest, if it so chooses.

However, there should not be any discrimination from customer to customer on interest rates for similar amount of deposit.

RBI hikes interest rates on NRE and FCNR(B) Deposits

In view of the prevailing market conditions, the RBI in November decided that the interest rates on Non- Resident (External) Rupee (NRE) Term Deposits will be as under:

- Interest rates on fresh Non-Resident (External) Rupee (NRE) Term Deposits for one to three years maturity should not exceed the LIBOR/SWAP rates plus 275 basis points, as on the last working day of the previous month, for US dollar

of corresponding maturities. The interest rates will also be applicable to deposits with the maturity period exceeding three years and to deposits renewed after their present maturity period.

The interest rate on NRE deposits was LIBOR/SWAP rates plus 175 basis points since November 15, 2008.

In case of Foreign Currency Non-Resident (Banks) [FCNR(B)] deposits, the interest rates will be as under:

- Interest rate on FCNR(B) deposits of all maturities contracted effective from the close of business in India as on November 23, 2011, will be within the ceiling rate of LIBOR/SWAP rates plus 125 basis points for the respective currency/corresponding maturities. Interest rate on floating rate deposits will be within the ceiling of SWAP rates for the respective currency/maturity plus 125 basis points and the interest reset period will be six months.

The interest rate on these deposits was LIBOR/SWAP rates plus 100 basis points since November 15, 2008.

RBI eases norms on small money transfers

With a view to facilitating fund transfers to people, particularly migrants, who do not have bank accounts, RBI in October relaxed norms by doubling the transaction cap on small money transfers. Under the new norms, the cash payout arrangements for amounts being transferred out of bank accounts to beneficiaries not having a bank account has been enhanced to Rs 10,000 from the current limit of Rs 5,000. The monthly cap on such transfer will be Rs 25,000 per beneficiary. Besides, customers not having bank account can now transfer funds to bank accounts of others, subject to a transaction limit of Rs 5,000 and a monthly cap of Rs 25,000 per remitter.

Interest subsidy scheme for exporters extended

The RBI in October announced 2 per cent interest subsidy on rupee export credit to the labour-oriented and small scale sectors to cushion them from slowdown in major markets like the U.S. and Europe. Exporters of handicrafts, handlooms and carpets will be eligible for the interest subvention to be available up to March 31, 2012. Exporters in the small and medium enterprises across all sectors would also be entitled for cheaper bank credit, subject to a minimum interest rate of 7 per cent.

RBI turns heat on banks to check bad loans

Following the recent downgrade of the country's largest lender State Bank of India by credit rating agency Moody's Investor Services, the RBI has asked banks to focus on recovery and follow a stringent credit appraisal procedure. The RBI has asked banks to remain cautious in the wake of a higher-than-expected rate hike that could have an adverse impact on the asset quality of banks.

Government clears changes in laws to deal with bad loans

The Government in October approved amendments to the

SARFAESI and debt recovery acts to enable banks to effectively deal with the menace of bad loans and also encourage them to disburse credit freely to home and corporate loan seekers. The Cabinet approved the introduction of the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Bill, 2011, in the next Winter Session of Parliament. The Bill seeks to amend the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act and Recovery of Debts due to Banks and Financial Institutions (RDBF) Act so as to strengthen the regulatory and institutional framework related to recovery of debts due to banks and financial institutions through the Enforcement of Security Interest and Recovery of Debts Laws (Amendment) Bill, 2011.

NRIs can hold accounts in any currency now: RBI

The Reserve Bank in October said Indians who have non-resident accounts in the country can now hold them in any currency which is fully convertible. The move is likely to help NRIs/Persons of India Origin as it will give them more options in the holding of accounts, and lessen the risk from fluctuations in major currencies. Earlier, FCNR(B) account holders were allowed to hold accounts in only certain currencies such as the Pound Sterling, US dollar, Japanese yen, euro, Canadian dollar and Australian dollar.

RBI for penalty waiver on prepayment of home loans

The RBI is in the process of directing banks to stop charging penalties for repayment of home loans ahead of schedule to ensure a level-playing field between banks and housing finance companies (HFCs). The RBI has decided to set up a Working Group to look into principles governing proper, transparent and non-discriminatory pricing of credit. RBI's move follows a similar directive to HFCs by their regulator, the National Housing Bank (NHB) earlier.

RBI seeks feedback on priority sector

The RBI has sought feedback from the public on 30-point terms of reference drafted for study by the committee on priority sector lending headed by Union Bank of India Chairman and Managing Director M V Nair. The terms of reference for the panel includes relooking at priority sector tag, ambiguities over direct financing, issue related to indirect financing issues, and penalties for violations of lending norms.

RBI raises housing loan limit for UCBs to Rs 30 lakh

The RBI raised the cap on individual housing loan an urban cooperative bank (UCB) can disburse to Rs 30 lakh from Rs 25 lakh. The central bank also raised repayment period for such loans from 15 years to 20 years. The housing loan limit for another category (tier-II) UCBs has been increased to Rs 70 lakh from Rs 50 lakh.

RBI okays new rules for structured derivative offers by banks

The RBI in November said banks may offer structured derivative products to customers for hedging risk. These should not contain any underlying derivative. The use of a structured derivative is in addition to generic derivative products like foreign exchange forward contracts and interest rate swaps which a bank can offer for risk management. RBI's revised norms said banks will need its approval prior to offering structured derivative products. Banks must seek a resolution of the customer-company board on the limit set for dealing in derivatives. (Earlier, companies had to specify limits for particular persons allowed to enter into derivative deals). This takes effect from January 1, 2012.

RBI relaxes norms for AMCs to open branches

The RBI has allowed AMCs including banks, to open additional branches in metros without adhering to the old criteria of maintaining a ratio in number of branches in metro and non-metros cities. In order to provide more flexibility to authorised persons to decide the location of their branches, it has been decided to dispense with the criteria of 1:1 ratio between metro and non-metro branches, according to the RBI notification.

RBI cuts lock-in to 1 year for FII investment in infra bonds, NCDs

In a bid to boost investment in the infrastructure sector, the RBI in November expanded the scope of FII investment in infrastructure bonds and non-convertible debentures to include such instruments issued by Infrastructure Finance Companies (IFCs). In the notification, the lock-in period of three years for FII investment has been slashed to one year up to an amount of $5 billion within the overall limit of $25 billion. This lock-in period will be computed from the time of first purchase by FIIs.

RBI eases share transfer rules to woo foreign direct investment

Liberalising and rationalising the procedures and policies governing FDI in India, the RBI has said transfer of shares between Indians and non-residents will not require its permission in several key areas such as financial services. The RBI permission has also been done away with for transfer of shares between

residents and non-residents in cases where the Foreign Investment Promotion Board (FIPB) has already given its clearances and the SEBI guidelines are met. Following the move, the RBI nod is not needed if the original and resultant investments are in line with the existing FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalisation, reporting requirements and documentation).

Reserve Bank eases rules for repayment of fixed deposits

RBI in a recent notification stated that signatures of both depositors are not needed for repayment of fixed or term deposits on maturity if such accounts are opened with instructions "either or survivor".

RBI allows RRBs for third party account pay in drafts

The RBI in November allowed RRBs to collect account pay drafts, pay orders for crediting proceeds to third party accounts with certain restrictions. Till date, it was only allowed in case of cheques. As per the central bank, the account payee cheques or demand drafts or pay orders should not exceed Rs 50,000 for crediting it to third party account. Also, the account payee should be a customer of these cooperative credit societies.

Large financial firms will be closely monitored: RBI

Considering the multi-national presence of large financial institutions and their role in the current global economic environment, the RBI is keeping a close watch on such institutions in the country. The central bank has set up a 'financial conglomerates monitoring division', which is currently overseeing twelve institutions that account for 53 per cent of the banking sector's total assets.

RBI allows banks, NBFCs to float infra debt funds

The RBI in November issued guidelines on Infrastructure Debt Funds (IDFs) paving the way for banks and NBFCs to float such funds, a move that will help in garnering long-term resources for the infrastructure sector. Banks and Non Banking Financial Companies (NBFCs) now will be able to sponsor IDFs, which can be set up either as Mutual Funds (MFs) or NBFCs. SCBs would be allowed to act as sponsors to IDF-MFs and IDF-NBFCs with prior approval from RBI, according to the central bank's guidelines on setting up IDFs. NBFCs with a minimum Net Owned Funds (NOF) of Rs 300 crore and Capital to Risk Weighted Assets (CRAR) of 15 per cent has been allowed to set up IDF-MF. As far as Infrastructure Finance Companies (IFCs) are concerned, they can sponsor IDF-NBFC.

RBI sets rules for reporting fraud

Looking to check banking fraud, the RBI has directed banks to report fraud cases, between Rs 1,00,000 and Rs 50,00,000, to the regional office of the department of banking supervision (DBS). The central bank's latest notification comes a few months after it directed public sector lenders to promptly report cases of cheating involving Rs 1,00,00,000 and above to the CBI and of lesser amounts to the police.

Capital Market

November 2011

SEBI on FII limit

SEBI notified increasing the limit for foreign institutional investors in government securities and corporate bonds by $5 billion each and said the bidding process for the additional amount would be conducted on November 30.

Foreign investors can invest in IDFs

RBI has allowed foreign investors to invest in debt instruments floated by infrastructure debt funds (IDF) set up as non-banking financial companies (NBFCs) or mutual funds (MFs). The debt instrument would include foreign currency and rupee bonds.

While both individual and institutional foreign investors are allowed to invest, the regulator has specified the instruments they are eligible to invest in. Eligible foreign investors include high net worth individuals registered with SEBI and high net worth individuals registered with SEBI as sub-accounts of SEBI-registered FIIs. Non-residents who fall under foreign exchange management regulations, 2000, are also eligible to invest.

Institutional investors eligible for investment in instruments issued by IDFs include sovereign wealth funds, multilateral agencies, pension funds, insurance and endowment funds and FIIs registered with SEBI. Investments by non-residents in foreign currency and rupee bonds issued by IDFs would be capped at $10 billion is within the $25 billion cap for investment by FIIs in the infrastructure sector. No cap is set for non-resident Indians for investment in rupee bonds issued by IDFs.

SEBI plans circuit filter from listing day

The SEBI is considering imposing circuit filter on the day of listing to check excessive volatility. If circuit filter is imposed on the listing day, price of the debutant share cannot go up or down beyond a level. The stock market regulator is working on measures to check manipulation in IPO. Usually such a manipulation ends with listing of the shares, where people try to get advantage of free movement of the price on day one. It was felt that mostly big investors get the benefit of such a price movement and retail investors do not get any sense about such a move and burn their fingers.

SEBI to revamp IPO process

SEBI said it was looking at revamping the initial public offering (IPO) norms. Earlier this year, SEBI had decided to introduce a new short and simple form for IPO investors for increasing retail participation in the stock markets. It is reported that SEBI is also considering expediting the clearance of IPO offer documents.

SEBI allows MFs to participate in repo corporate debt securities

SEBI allowed mutual funds to invest in repo, or short-term repurchase of forward contract, of corporate debt securities with a ceiling of 10% of the net assets of the concerned scheme. To enable the investors in such schemes take an informed decision, MFs have been directed to give details in the scheme information document on the exposure limit for the scheme and the risk factors associated with repo transactions in corporate bonds.

SEBI wants MF houses to rope in more brokers while launching ETFs

SEBI has told fund houses to strengthen market making while launching exchange-traded funds (ETFs). The regulator wants fund houses to empanel more brokers as market makers and allot a larger trading book to them for creating liquidity on the exchange. In the case of gold exchange-traded funds, the regulator wants asset management companies, or fund houses, to appoint more bullion traders who have exchange memberships as market makers. Exchange-traded funds require a strong exchange platform as they are traded on the exchanges intra-day. A market maker is usually a broker who buys or sells a particular stock or fund unit (in case of ETFs) on a regular and continuous basis at a publicly-quoted price. The market maker does spread trading, hoping to make a profit on the bid-offer spread, or strike a profitable buy or sell deal. According to executives in a few mutual funds, the regulator's move is aimed at boosting liquidity on the exchange and create more counter-parties for these products.

SEBI seeking to nip mart nexus

SEBI is considering a new set of norms to check 'conflict of interests' in the stock market, as it looks to rein in any nexus amongst the corporates, research analysts, investment advisors and various market entities. The new rules would look at discouraging misaligned employee incentives — a practice prevalent among capital market entities for rewarding their staff on the basis of business generated by them irrespective of interest of customers or investors being safeguarded. SEBI is framing these rules in accordance with a new set of initiatives proposed by the International Organisation of Securities Commissions (IOSCO) to safeguard the markets across the world from any irregularities. The major sources of 'conflict of interests' include closely-held structure of Indian corporates, cross-holding among the companies, a dominant role of promoters in governing the companies and “tunnelling” or diversion of funds between different firms within the business groups.

SEBI asks fund houses to display agent fees on websites

SEBI asked fund houses to publicly display the commission they pay to distributors for selling mutual funds, a move aimed at bringing in transparency in fee structure. The regulator has asked asset management companies to disclose commission paid to distributors between April 1, 2010 and March 31, 2011, on or before November 10, according to a circular issued to fund houses. The information has to be published on the portal of the industry body Association of Mutual Funds in India and on websites of respective fund houses, AMFI sources said. Industry sources said these distributors will be scrutinised more closely by the regulator as they handle large business volumes.

SEBI to help bring small investors back to IPOs

SEBI plans to set up a committee that will suggest ways to revive the country's primary market and make it more efficient. The panel will focus on ways to bring back the retail investor and find ways to reduce transaction costs that currently reach a prohibitive 10% for issues below Rs 50 crore, review quotas for various investor categories, study the role of merchant bankers selling an IPO and reduce the gap between closing an issue and listing the stock. This will be different from the Primary Market Advisory Committee that advises the regulator on immediate issues of concern. The regulator has informed the Finance ministry of its intention to set up the committee.

October 2011

SEBI move

SEBI allowed sub-brokers to carry out 'In-person' verification (IPV) of clients. However, the ultimate responsibility for 'in-person' verification would remain with the subsidiaries and they shall obtain the necessary IPV documents for their records, it added.

New takeover rules by SEBI come into force

Widely known as the Takeover Code, the new regulations were notified by the Securities Exchange Board of India in September 2011 and have accordingly become effective from 22nd October 2011. With these rules coming into force, both promoter and public shareholders of a listed company would now get the same price for their shares being purchased by an acquirer. At the same time, an acquirer would have to make an open offer for purchase of a minimum 26 per cent stake from public shareholders, as against 20 per cent earlier. The new rules would also help the listed companies to get more investment from private equity

players and other investors who are not interested in a takeover, as the trigger point for an open offer has been raised to 25 per cent from 15 per cent earlier. Now, an entity needs to make an open offer only if its holding reaches threshold limit of 25 per cent, as against 15 per cent earlier. The new regulations replace the takeover rules that were in force since 1997.

SEBI asks firms to disclose all share purchases

SEBI asked companies to disclose details of share purchases by acquirers and persons acting in concert (PAC) to include all voting rights and warrants held by the promoters and other insiders during their regulatory filings with stock exchanges. Under the new format, they (acquirers and PAC) have to provide additional disclosures about warrants and any other instrument which have voting rights, besides their disclosures regarding acquisition of shares/voting rights/ and holding by them in the target company. The disclosures are mandatory. The acquirer also has to disclose equity share capital, total voting capital of the target company before and after the acquisition as well as total diluted share/voting capital of the target after the said acquisition.

Insurers get profitability clause waiver for IPOs

SEBI has withdrawn a major irritant for life insurance companies wanting to hit the capital market with initial public offers. While clearing IPO guidelines of life insurance companies, the regulator has removed the three-year profitability clause that is applicable for all companies as a precondition for tapping the capital markets. However, insurance companies will have to go for additional disclosures as required by IRDA over and above the disclosure norms set by SEBI.

SEBI restructures Primary Market Advisory Committee

The capital market regulator has got new members for the Primary Market Advisory Committee (PMAC). The 18-member PMAC advises SEBI on policy framework related to the primary markets. The SEBI has replaced 11 of the existing members in PMAC.

SEBI announces uniform KYC norms for securities market

SEBI announced introduction of uniform forms and documents for the purpose of customer identification by different market intermediaries like stock exchanges and mutual funds. The new KYC form will have space for giving identity details including name, nationality, PAN and/or UID number besides details like address, gross annual income and occupation. In addition, additional information specific to dealing in stock exchanges is also included in the form. The customers will also have to furnish various documents relating to their identity, proof of address and other facts. In case of corporates, they will have to provide copy of balance sheet for last two financial years, copy of latest holding pattern in their firm, copies of memorandum and articles of association and copies of board resolution for investment

in securities market. Foreign Institutional Investors will have to furnish copy of SEBI registration certificate, while registered societies will have to provide copy of such certificate and list of managing committee members.

SEBI mulls new regulations on companies' disclosure

SEBI is considering a new set of regulations for disclosure of only relevant risk factors by the companies in a format that is easy to understand for the investors. Besides, the regulator is also planning changes in norms to bring in more clarity in the disclosure of 'related party transactions' and litigations faced by companies. It is reported that SEBI is concerned over the current practice of companies overloading investors with bulky documents of risk factors that are general in nature, but disguising even business specific risks as ones having generic consequences.

SEBI revises bidding norms for FIIs in infra bonds

Revising its norms for foreign institutional investors (FII) in the infrastructure debt bonds, SEBI lowered the minimum bidding and allocation amounts for such investors. As per the revised guidelines, no single FII shall be allocated more than Rs 2,000 crore of the investment limit against the existing Rs 10,000 crore. The market regulator has also reduced the minimum bid size to Rs 50 crore from the existing Rs 250 crore, a SEBI circular said.

SEBI extends deadline for promoters to demat holdings to December quarter

The SEBI in October extended the deadline for promoters of listed companies to demat 100 per cent of their holdings to the quarter ending December this year. The last minute decision – the initial deadline expired on September 30 – by the securities regulator came amid speculation that a large number of stocks will move to Trade-to-Trade segment (T2T) of stock exchanges, where netting of buy and sale position in the same stock is not permitted.

Insurance Sector

Insurance companies can't refuse a claim even if the request comes in late

Insurers can no longer refuse honoring a claim just because the request for a claim came in late. According to recent guidelines issued by IRDA, even a late claim should be entertained, especially when the reason for delay is a genuine unavoidable circumstance.

Health insurance Portability

Health insurance portability came into force in October as mandated by the IRDA earlier. Those who seek to

switch to a new general insurer should apply at least 45 days prior to the expiry of the policy. It is not binding on the insurer to extend portability if the requests are not made in time. Portability is permitted only between non-life insurers. At present, there are 24 general insurance companies in the country.

IRDA tightens anti-money laundering regulations

From November insurance premium beyond Rs 50,000 can be paid in cash only if policy holder has a permanent account number (PAN). The insurers should verify the authenticity of the permanent account number, according to the modifications in the anti-money laundering norms announced by the IRDA in October. This move would help the authority track sources of funds.

IRDA asks insurers to follow uniform pricing

According to circular issued by IRDA, the life insurers will have to follow a single uniform pricing methodology for calculating NAV and update it every day. Insurers followed different pricing methodologies, based on appropriation (units purchased) and expropriation (units sold), where they charged an additional amount that inflated NAV. The current guidelines mandate insurers to remove the appropriation and expropriation.

IRDA: Ulip holders to get interest if they discontinue policies midway

Holders of unit- linked policies who discontinue their policies mid- way shall get a minimum guaranteed interest at par with SBI savings bank account rates, regulator IRDA said.

Changing the rules, the IRDA also asked the life insurers that the policyholders unit- linked insurance products (Ulips) should be allowed to revive their cover within two years of stoppage of premium payment, but not later than the expiry of lock- in period.

Further, the policyholders would be duly compensated for the discontinuation charges in case the policies are revived.

Insurers get profitability clause waiver for IPOs

The Securities and Exchange Board of India (SEBI) has withdrawn a major irritant for life insurance companies wanting to hit the capital market with initial public offers. While clearing IPO guidelines of life insurance companies, the regulator has removed the three-year profitability clause that is applicable for all companies as a precondition for tapping the capital markets. However, insurance companies will have to go for additional disclosures as required by the Insurance Regulatory Development Authority (IRDA) over and above the disclosure norms set by SEBI.

IRDA Plans to Ban Misleading Products

The IRDA plans to ban misleading products and stagger commission for agents to ensure that policy buyers are not short changed. The insurance industry, which is still evolving a decade after privatisation, needs new rules to ensure that consumers get the best and don't get carried away by products that only promise high returns on paper, the regulator has said. Insurance companies, bitten by the slump in sales after new rules curbing Ulips, are peddling many policies that on close scrutiny could be termed deceptive.

IRDA may end third party insurance pool

The insurance regulator is contemplating scrapping the third

party motor pool from which claims of all accident victims are settled, possibly doubling the insurance premium for millions of automobile buyers.

IRDA may allow agents to sell products of more than one insurance company

The IRDA plans to allow agents to sell products of more than one insurance company, allowing private insurers to access the vast army of agents selling products of the market leader - the Life Insurance Corporation (LIC). Agents can sell products of only one insurer under existing norms, but the current global trend was to do way with tied agents, who can retail products of only one company. "The idea is to allow agents to sell products of more than one company. This model has been tried in Hong Kong. In England, tied agents have vanished.

IRDA directs motor insurance companies to ensure nomination papers are duly filled

Insurance regulator IRDA has warned non-life insurers against evading claims on the mandatory personal accident cover that these companies are required to provide with each motor insurance policy. The directive follows complaints that insurers have evaded crores of rupees in claims, because either the consumers were not informed or the nomination papers were not properly filled in. The Lucknow bench of the Allahabad High Court had, in April, asked IRDA to ensure that personal accident cover is duly provided with each policy.

IRDA guidelines to prevent misselling of insurance policies

In order to prevent misselling of insurance policies through distance marketing and to protect consumer interest, the IRDA brought into effect from October 1 this year its guidelines on distance marketing of insurance products. The guidelines, which apply to every activity of solicitation and sale of insurance products through the internet, e-mail, snail mail, newspaper inserts, SMS and telephone, mandate that every insurer prepare a standardised script for the purpose and file this with the regulator.

Motor insurance policies must have names of nominees: IRDA

In order to streamline settlement of claims by insurance companies, the IRDA has made it mandatory for persons seeking motor insurance to mention the name of nominee at the time of buying the policy. As per a circular sent to the insurance companies, the IRDA has asked them to ensure that the name of nominee is mentioned in the policy document at the time of giving cover for private vehicles.

Guidelines on listing of life insurers soon: IRDA

IRDA hopes that the listing guidelines for life insurance companies, which have been agreed upon by SEBI will be issued soon. The move may bring in consolidation in the sector because many insurance companies will be completing 10 years of operations, which would allow them to get listed on the bourses, as proposed by the regulator. The regulator also indicated that it is not in a hurry to scrap the third-party motor insurance pool as demanded by the general insurance industry.

IRDA scraps 4.5% guarantee clause

The IRDA scrapped 4.5% guarantee on capital while unveiling the final set of pension guidelines in November. Insurers will henceforth specify assured benefits on pension plans, applicable on death, surrender or vesting. The proposed guideline shall come into effect from December 1. As per the new guidelines, the regulator is recommending insurance companies give a guarantee on capital — which is anything higher than zero percent. The upshot would be that it makes the pension markets more competitive as different players will offer different rates of return. The new guideline says that the pension products may have a life insurance cover during the deferment period (time period between the accumulation phase and the annuity phase). The new guidelines enable the nominee to withdraw the entire corpus which he or she can utilize it for buying an annuity.

Ulip norms relaxed

ULPPs have been out of circulation for a while, after the IRDA imposed a guaranteed-returns clause on them last September. The IRDA has now relaxed its norms on guarantees. The new norms, to be effective from December 31, could trigger a partial revival of the pension Ulips category.

Banking model for Insurance

Insurance companies should also explore banking like correspondent model to boost penetration of insurance products in the country, said J Hari Narayan, chairman, IRDA. In order to increase the penetration of banking services in the rural areas, Indian banks have adopted low cost business correspondent model in which a person, with a help of handheld device, provides the basic banking services in the villages.

IRDA hints at curbs on NAV-based products

The insurance regulator in November said it was examining the high-guaranteed net asset value (NAV) products and will take a decision on them soon.

IRDA tightens rules for web portals selling insurance products

The IRDA has tightened rules for Web sites and portals vending insurance products. As per IRDA's draft guidelines, companies will now need to have a minimum net worth of Rs 10 lakh. They will have to register themselves with IRDA to become eligible for providing important information related to the insurance sector on their Web sites. The new guidelines will help standardise norms.

FICCI's Annual Capital Markets Conference viz. CAPAM 2011

September 7, 2011: Mumbai

FICCI organized the 8th edition of its Annual Capital Markets Conference, viz., CAPAM 2011 on September 7, 2011 in Mumbai. McKinsey & Company was the Knowledge Partner for the event.

The theme of this year's conference was 'Developing capital markets to develop the economy'. The main issues discussed at the Conference included macro-economic outlook for Indian economy and role of capital market in funding growth, moving Indian households' savings to capital markets - opportunity and challenges, making capital market more accessible to issuers and investors and corporate bond market.

Dr. Subir Gokarn, Deputy Governor, Reserve Bank of India delivered a Special Address and Mr. Prashant Saran, Whole Time Member, Securities and Exchange Board of India (SEBI) delivered the Keynote Address at the Conference.

The participants at the conference included senior representatives of industry, financial institutions, representatives from FIIs, brokers, banks, stock exchanges, merchant banks, financial analysts, fund managers, investors, economists, academia and media.

A knowledge paper on 'Developing capital markets to develop the economy' and a 'handbook of statistics on Indian capital markets' were released during the Conference.

Consultative Meeting on draft National Competition Policy

22nd September, 2011, FICCI, Federation House, New Delhi

FICCI in association with the Ministry of Corporate Affairs and Indian Institute of Corporate Affairs organized a Consultative meeting on the draft "National Competition Policy" on Thursday, 22nd September, 2011 at FICCI, Federation House, New Delhi.

Dr. M. Veerappa Moily, Hon'ble Minister for Corporate Affairs chaired the consultation session. Mr. Naved Masood, Secretary, Ministry of Corporate Affairs delivered the Opening Remarks. Mr. Sidharth Birla, Chairman, FICCI Corporate Laws Committee and Chairman, Xpro India Ltd. delivered the Welcome Remarks.

Presentations on the National Competition Policy were made by Ms. Vijaya Sampath, Co Chair, FICCI Corporate Laws Committee and Advisor to Chairman, Bharti Group, Mr. Dhanendra Kumar, Chairman, Drafting Committee on National Competition Policy and Mr. Pradeep Mehta, Secretary General, Consumer Unity and Trust Society.

The Ministry of Corporate Affairs had constituted a Committee for framing of National Competition Policy and related matters, under the Chairmanship of Shri Dhanendra Kumar, Former Chairperson of Competition Commission of India. Competition law being a sub-set of the Competition Policy, the National Competition Policy is an overarching Policy framework to infuse greater competition across sectors and once implemented, it will also bring under its fold various sectoral regulators and their possible role in ensuring competition in the concerned sector.

The Consultation Session aimed to discuss, evaluate and seek industry's feedback on the Draft National Competition Policy before it is finalized.

Financial Inclusion : Partnership between Banks, MFIs and Communities

October 14, 2011 at FICCI, Federation House, New Delhi

FICCI in association with UNDP organized a Seminar on "Financial Inclusion: Partnership between Banks, MFIs and Communities" on October 14, 2011 at FICCI, Federation House, New Delhi. M-CRIL was the Knowledge Partner for the event.

The theme of the Seminar on Financial Inclusion was 'Partnership between Banks, MFIs and Communities'. The main issues discussed at the Conference included bankers' initiatives and their role in promoting Financial Inclusion, Perspective of vulnerable communities and social groups on supply side issues and Strategies & Approach towards Financial Inclusion.

Dr K C Chakrabarty, Deputy Governor, Reserve Bank of India inaugurated the Seminar and delivered the Keynote Address at the Conference.

The participants at the conference included senior representatives of Banking and Financial Services Sector, Micro Financial Institution (MFI's), Non-Government Organizations (NGOs) & Self-Help Groups (SHG's), Non Banking Finance Companies (NBFC's), Policy makers and regulators, Technology providers, Community based organizations, Service Providers, Consultants, Researchers et al.

A knowledge paper on 'Promoting Financial Inclusion' was released by Dr K C Chakrabarty during the Inaugural Session of the Seminar. The study analyzed the role played by banks hitherto in creating Financial Inclusion and future strategy they need to adopt to make further progress.

SESSIONS AT THE SEMINAR

1. Inaugural Session to discuss Financial Inclusion: Current Scenario
2. Role of Banks in Broadbasing Financial Inclusion – Perspective on Supply Side issues
3. Strategies & Approach towards Financial Inclusion

Interactive Session with Mr. D K Mittal, Secretary Financial Services, Govt. of India,

9th November, 2011 at ITC Grand Central, Lower Parel, Mumbai.

FICCI organized an Interactive Session with Mr. D K Mittal, Secretary, Financial Services, Govt. of India on 9th November, 2011 at ITC Grand Central, Lower Parel, Mumbai.

The aim of the meeting was to discuss the financial sector reforms critical for economic growth. Mr. Mittal interacted with FICCI's Financial Sector Committees, which included the Committees on Banking & Financial Institutions, Capital Markets, Financial Inclusion, Corporate Finance and Insurance. The meeting from FICCI's side was chaired by Ms Naina Lal Kidwai, Vice President of FICCI and chair of the FICCI Financial Sector Forum, comprising all the above-mentioned Committees.

Some of the new issues discussed were as follows: New Bank Licenses, Banking Amendment Bill, M&A in Banking Sector, Insurance Amendement Bill, Taxation Issues (DTC), New distribution channels, Giving boost to Micro Insurance, Renewal of fund flows to the sect, Micro Finance Bill, Improving credit underwriting, monitoring and collections capability given the economic environment, Capital for the industry given growth and Basel III, Relevance of NBFCs in the economy, FICCI's views on Usha Thorat Committee Report, Regulatory concerns facing the ARCs business, Corporate Bond Market, New Pensions Scheme.

Roundtable on “Developing Capacities to Tackle Chronic Diseases”

November 14, 2011, Federation House, New Delhi

Chronic diseases have emerged as the leading cause of mortality world-wide and their impact is expected to grow especially in a young country like India. Due to emergence of diseases like Diabetes, cardiac ailments and other chronic diseases India has now been classified as the Diabetes capital of the world. The growing burden of non-communicable diseases in India is expected to double to 57% by the year 2020 up from just 29% in 1990.

Keeping in view the growing need to focus on Chronic Diseases through prevention, insurance cover and other strategies to tackle the growing peril, **FICCI organized a roundtable supported by India Health Progress on “Developing Capacities to Tackle Chronic Diseases”** on **November 14, 2011** at Federation House, New Delhi. **The roundtable mainly focused on our planning to deal with the growing menace of chronic diseases including affordable disease management solutions, widening of the insurance net to cover chronic ailments and drugs for treatment. Special focus was sought on diabetes and cardiovascular diseases.**

The 2 hour session was chaired by **Dr Nandakumar Jairam**, Co-Chairman, FICCI Health Services Committee & Chairman and Group Medical Director, Columbia Asia Hospitals India and **Mr. Keshav Desiraju**, Additional Secretary, Ministry of Health and Family Welfare, Government of India delivered the '**Special Address' at the roundtable.**

INDIA INVESTOR MEET

“Theme: Investor Awareness – A Key to Corporate Growth”

January 12, 2012, FICCI, Federation House, New Delhi

FICCI, keeping in view its social objective, in collaboration with the Ministry of Corporate Affairs, Government of India is organizing "India Investor Meet" on 12th January 2012 at Federation House, Tansen Marg, New Delhi. The theme for the meet is "Investor Awareness - A Key to Corporate Growth"

Despite high household savings rate in India, share of financial savings in household savings is significantly low. One of the key reasons is lack of reach of financial products as well as low awareness levels. There is a need to create understanding of the costs and benefits of various financial services, the impact of inflation on savings, and the tradeoff between risk and return. This would help households choose the right products for their needs and weed out dubious schemes from truly beneficial ones. The "India Investor Meet" therefore intends to bring national focus on the subject of investor awareness with a view to create a larger pool of informed investors and simultaneously encourage a greater number of common people to participate in the corporate economy through various investment instruments.

Shri M. Veerappa Moily, Hon'ble Minister, Ministry of Corporate Affairs, Government of India has kindly agreed to deliver the Keynote Address at the event. Smt. Sheila Dikshit, Hon'ble Chief Minister of the Government of NCT of Delhi has also been invited to be the Guest of Honour at this occasion.

7th Edelweiss India Investor Conference, 'Corridors of Power' in association with FICCI

6th February 2012 at the Taj Mansingh, New Delhi

The 7th Edelweiss India Investor Conference, 'Corridors of Power' in association with FICCI will begin on 6th February 2012 at the Taj Mansingh, New Delhi. This event, called 'Corridors of Power', in New Delhi, will feature a series of Keynote Addresses, Panel Discussions and Debates on Policy, Regulation and the Government's vision for India during these challenging times. We are inviting a marquee panel of prominent ministers, bureaucrats, regulators and officials to interact with the crème-de-la-crème of the investing and corporate worlds, and thus provide attendees an enriching set of insights.

The conference promises to bring together some of the wisest minds in investing, business and government over the three days. The conference is expecting large scale participation from

- Over 100 leading Indian companies spanning the NIFTY, Sensex, Sector and Mid-cap indices
- Indian institutions like ICICI Prudential Life Insurance, HDFC MF, Bajaj Allianz Life Insurance, ICICI Prudential MF, Reliance MF, DSP Blackrock MF, UTI MF, SBI MF, HDFC Standard Life and others
- Global investors such as Templeton, Morgan Stanley, EMIC, J P Morgan/JF Asset Mgt, Fidelity Investments, HSBC Halbis, Treeline and others.

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