

Startup Funding Stuck in the Sebi Maze

Expert Take



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Indian securities market regulator Sebi, in its recent press release, has cautioned investors to stop dealing on any unauthorised electronic platform, which facilitates the fund raising for startups and other entrepreneurial setups. The said Sebi move has the potential to disrupt India's startup ecosystem.

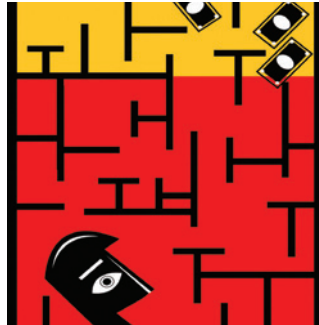
There are hundreds of national/regional fund-raising platforms, which have actively existed for the past many years. Globally, such platforms, which are essentially equity crowdfunding in nature, have acted as a viable alternative to the interfering venture capital money and increasingly unavaila-

ble bank financing. As per publicly available information, \$34 billion has been globally raised through crowdfunding in the year 2015. In essence, such platforms act as matchmakers between the potential investors and the entities that are in need of funding. The platform may charge a subscription fee from the investors and also charge the investees in the form of a fee or a minority stake.

The Securities and Exchange Board of India (Sebi) has pointed out contravention of the Securities Contracts (Regulation) Act, 1956 [SC(R)A] and the Companies Act, 2013 as the reason behind its move. As per Sebi, only recognised stock exchanges can provide a platform where securities have to be listed and traded. Sebi has also assumed that the offer made on the platform is likely to violate the private placement norms under the Companies Act.

Sebi's directive seems to be misplaced for several regulatory as well as commercial reasons.

First, to term the equity crowdfunding platform as a stock ex-



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change is incorrect. It's a settled legal position that the definition of "securities" under SC(R)A covers all "marketable securities", whether listed or not. Under SC(R)A, technically, any entity which assists buying, selling or dealing in securities is a 'stock exchange'. However, Sebi, literally applying the rule, has treated an equity crowdfunding platform as a stock exchange, since share sale can be facilitated on the same. By that logic, anybody facilitating a security deal (whether or not on an electronic platform) can be termed as a

stock exchange. A crowdfunding platform merely acts as an arranger without regulating the actual trades and the companies whose shares are dealt on it are in no position to get listed and hence, comparing such a platform with a stock exchange defies logic.

Second, Sebi in the absence of an appropriate regulatory regime has released a press release attempting to ban the platforms by citing vague legal references, and not by way of a reasoned communication. The preferred means of regulating such activities would have been by way of notifying the crowdfunding regulations which Sebi has conveniently ignored over the past several years post first releasing a consultation paper in 2014.

Third, as far as the possible violation of company law is concerned, the private placement norms can be complied with by making limited offerings as permitted under the company law (by making less than 200 offers in a financial year). Hence, suspicion of a potential violation cannot be the reason to stop an activity.

The crowdfunding networks have tremendously helped the Indian startup ecosystem. If such networks with reputed investor base and an organised framework were to shut shop, the implications can be negative for the overall economy. 'Angel fund' regime under the Sebi (Alternative Investment Funds) Regulations is yet another example where Sebi's stringent regulatory norms didn't let it succeed, which otherwise could have opened floodgates for the startup fraternity. Realising the concerns, Sebi is likely to consider liberalising the 'angel fund' regime. Accordingly, Sebi should also consider notifying the crowdfunding regulations to fill the regulatory vacuum, rather than implying a blanket ban through inappropriate application of laws. Since equity crowdfunding in future is estimated to globally surpass the venture capital funding, the importance of the former cannot be understated. Hope Sebi is listening.

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