



A Private Equity Fund

Dedicated to Nepal

Regulatory Issues in Private Equity Investment in Nepal

Final

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ABBREVIATIONS

1.	AIF	Alternative Investment Fund
	BAFIA	Bank and Financial Institution Act, 2006
	CCDS	Compulsorily Convertible Debenture Shares
	CCPS	Compulsorily Convertible Preference Shares
	DCF	Discounted Cash Flow
	DFID	Department for International Development (UK)
	DIPP	Department of Industrial Policy and Promotion
	DOI	Department of Industry
	Draft FITTA	Draft Foreign Investment and Technology Transfer Act
	DTA	Double Taxation Treaty
	ECB	External Commercial Borrowings
	FDI	Foreign Direct Investment
	FITTA	Foreign Investment and Technology Transfer Act, 1992
	IEA	Industrial Enterprises Act, 1992
	IPO	Initial Public Offering
	IRD	Inland Revenue Department
	ITA	Income Tax Act, 2002
	LLP	Limited Liability Partnership
	MCR	Minimum Capital Requirement
	NRB	Nepal Rastra Bank
	NRN	Non-Resident Nepalese
	OCR	Office of the Company Registrar
	PE Fund	Private Equity Fund
	SAARC	South Asian Association for Regional Cooperation

	SEBI	Security Exchange Board of India
	SEBON	Security Exchange Board of Nepal
	SME	Small and Medium Scaled Enterprises
	VCF	Venture Capital Fund
	VCU	Venture Capital Undertakings

Disclaimer

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The objective of the report is to review and analyse the existing regulations for foreign private equity investment in Nepal and make comparative review with similar practices in SAARC countries. The chapters on entry options, operational issues, tax aspects of private Equity fund in Nepal has been prepared by Pioneer Law Associates while the introductory chapter and the chapter on repatriation and exit has been prepared by Kriti Capital and Investments Ltd. The report has been prepared based on publicly available information, interview with related stakeholders, review of related regulations, and practical experience related to foreign investment and capital market of the Pioneer Law and Kriti Capital. The implications, issues and suggestions of reforms are the views of the Pioneer Law and Kriti Capital and does not necessary represent the views of Dolma Development Fund.

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EXECUTIVE SUMMARY

This report was commissioned to study the legal and regulatory environment concerning the entry, exit and operation of the Private Equity Funds (the "PE Funds") in Nepal.

The PE Funds for the purpose of this report should be understood as a registered fund (both offshore and onshore) which pools the investible funds through private particularly by selling bonds, debentures and other forms of assurance and carefully invests in equity or risk capital in targets identified and selected by investment experts in the PE Funds through loan, equity and other hybrid instruments.

This report was produced with a joint mandate to review existing legal and regulatory framework, identify bottlenecks and caveats concerning the operation and exit the of PE Funds and also mandated to suggest possible short term and long terms reforms to be undertaken in view of providing comfortable legal and regulatory environment for PE Funds in Nepal.

Nepalese Law does not have a single and comprehensive regulatory framework to provide for regulation of the PE Funds like our neighboring SAARC nations. Legal provisions and requirements applicable in the context of setting-up, operation and exits of the PE Funds are scattered in different laws.

Theoretically, three different types of PE Funds: - (a) Offshore PE Funds (the funds which are registered and organized outside of Nepal), (b) Foreign Onshore PE Funds (the funds which are registered in Nepal after obtaining the regulatory approvals including the approvals for the foreign investments), and (c) Domestic Onshore Funds formed fully owned by the local investors, can invest in Nepalese portfolios and targets subject to obtaining of investment approvals and some regulatory restrictions.

ENTRY ASPECT OF THE PE FUNDS

ABSENCE OF BLANKET AND AUTOMATIC APPROVAL PROCEDURES

Automatic approval route and blanket approval route are not yet allowed for foreign investors in Nepal. The Offshore PE Funds are required to obtain approval, at least from: - (a) Investment Board or Industrial Promotion Board/Department of Industries (depending upon the size of investment) and from Nepal Rastra Bank (NRB; the Central Bank) before they can invest in portfolios of permitted sector Investment from the Offshore PE Funds, whatever the case may be, are regarded as the foreign investment and are subject to the negative list, implied positive list and permissibility of the investment instrument. Approvals from the authorities are required in every instance of investment and divestment making the foreign investment cost intensive and time consuming. Operation of the FITTA's Negative List, IEA's implied positive list¹, sectoral caps under different scattered policies and the prohibitive treatment of investment instrument leave only a few sectors open for Offshore PE Funds investment.

¹ As a matter of practice, foreign investment is allowed only for the sectors which are identified as Industrial sector under IEA.

MINIMUM CAPITALIZATION NORMS

Minimum capitalization requirement is also a serious obstacle preventing the Offshore PE Funds to select to inject seed capital in the small and medium enterprises (SMEs) and venture capital undertakings. While at present such general minimum capitalization requirement for foreign investment is fixed as Rs. 5 Million, the Draft FITTA is expected to increase it up to USD Ten Million (Rs. 956,800,000 calculated at the exchange rate of USD 1 = 95.68) making the situation worse than before for the SMEs. Such requirements may be relaxed for certain sectors of the SMEs and Venture Capital Undertakings to boost up investment in such sector.

NEGATIVE LIST, POSITIVE LIST AND SECTORAL CAPS

Negative List in the FITTA, implied positive list in the IEA and sector specific caps scattered on different policies for foreign investment has left only a handful of sectors open for foreign investment in Nepal. There are no public documents which provide for exhaustive list of the sectors that are open for foreign investment and the approach by the authorities in interpreting the 'implied positive list' is highly inconsistent, for example: While casinos are being operated under foreign investment and are allowed to do so, at present, proposals to operate Casinos under Foreign Investment are being rejected at the DOI showing the implied positive list. The Draft FITTA has proposed to impose/ prescribe sectoral caps on additional number of sectors for investment than which are currently available.

TREATMENT OF THE FOREIGN LOANS

NRB approach in treating/allowing foreign loans and foreign investment through different investment instruments also present itself as a caveat in investing in Nepal. The company can avail foreign loan subject to following conditions: - (a) only if the company cannot avail loan from domestic banks and financial institutions; (b) the interest rate under foreign loan is lower than prevailing interest rate in domestic market. NRB's restrictive condition in repayment of foreign debt is also an issue that cannot be overlooked. NRB allows the debtor availing foreign loans only in the following conditions - (a) if it does not have any debt payable to local banks and financial institutions, and (b) if it is not blacklisted as a defaulter. The restrictive approach in treating foreign loans needs to be revised in order to allow the Onshore PE Funds to avail foreign loans.

LIMITED INVESTMENT INSTRUMENTS

The investment options available to the Offshore PE Funds are very limited. Pursuant to BAFIA, only licensed bank and financial institutions are authorized to carryout banking and financial institutions and the tragedy for the Onshore PE Fund is that their lending function has been recognized as banking transaction under Section 47 of the BAFIA. As the Banking Function is reserved for licensed Banks and Financial Institutions, PE Fund or any Investment Company are restricted to make any loan investment. Unless NRB and other stakeholders remove this restriction, Offshore PE Funds will be restricted to invest in the portfolios of targets/undertakings by way of loan or any other instrument that have element of debt.

Regulation of the PE Funds (both Onshore and Offshore) through the scattered provisions makes the regulatory environment complex and cumbersome. Requirement to obtain approvals for doing/ executing nearly everything: each instance of investment, divestment, and return of sale proceeds following arduous

procedures increasing the cost and time of investment and affecting the investor's ability to make swift decisions. Lack of sufficient clarity in the existing laws: to take an example, lack of sufficient clarity on the areas where an investment company can invest its money out of its fund and by which instrument, has also aided to make the situation unfriendly for entry of PE Funds as well as investment in portfolios of chosen targets and undertakings.

The scattered provisions applicable in course of setting up or operation and exit of the PE Funds has make PE Funds regime confusing and less predictable. A single notification of authorities, say NRB's exchange control notification, can have a potential effect to shut down the entire business of PE Funds. To deal with the uncertainty and inconsistency at the present, a special and separate regulatory regime to deal with PE Funds which supersedes the provisions of all other law is the need of the time.

The PE Funds may be categorized into two or more different forms under a single regulatory framework to deal with the necessity to treat them differently. For example, PE Funds investing solely investing into Venture Capital Undertakings or SMEs may be categorized as 'A' type PE Fund and those one investing solely in diverse portfolios in secondary market may be classified as 'B' type PE Fund. Classification of the PE Funds on the basis of their investment function makes it easier to prescribe separate regulatory requirement and conditions considering the peculiarity in their investment functions in an efficient way. The recent SEBI Alternative Investment Fund Regulation in India can be taken as an example where the PE Funds investing in VCUs and/or PE Funds investing in the listed shares has be categorized into different types and the requirements are prescribed separately.

OPERATIONAL ASPECT OF PE FUNDS

The PE Funds will not be left at a problem-free-zone after entering into the market or making investment in Nepalese Portfolios following arduous procedures. There are several regulatory and legal issues which hinder the smooth operational aspects of the PE Funds.

PENALTY DRIVEN FILING REQUIREMENTS

The first issue here is the numerous filing requirements. Failure to comply with the filing requirements will attract the penalty and the concerned authorities are very much adept in using sledgehammer approach in imposing penalties. Companies registered in Nepal are required to file corporate documents before the Office of the Company Registrar ("**OCR**") and some filing requirements appear to be irrelevant and unnecessary. Certain requirements like: annual filing of share-capital structures (even when there has been no change in capital structure for a period), the requirement to inform regarding appointment of auditor etc. appears to be irrelevant. Failure to file the corporate documents within the stipulated time will make the companies liable to pay fines and penalty and the amount of payable fine increases with the passage of time.

In some cases the nominee directors in the investee companies appointed by investor PE Funds are themselves liable to fines and imprisonment for failure to comply with filing and reporting requirements.

RESTRICTION TO INDEMNIFY THE DIRECTOR'S LIABILITY

Directors are personally liable to fine of up to Rs. 50,000 and imprisonment of up to 2 years for failing to comply with the provisions of the Companies Act, 2006. The Companies Act restricts any company to indemnify directors against personal liability. Moreover, the director's liability insurance policy cannot be easily purchased from the local market. Strict liability on the part of directors and absence of any cushion against such liability may deter the PE Funds or their investee undertakings to take risky-yet-strategic decisions. Some qualified directors may find it difficult to become a member of the Board as they may face imprisonment if anything was to go wrong in the company..

LIMITATION ON DELEGATION OF AUTHORITY

It is not always possible for the Board of Directors to sit and make investment decisions each and every time. Customarily, PE Funds appoint or contract an investment manager(s) and investment experts to make investment decisions. However, the Companies Act, 2006 has reserved the authority of making decisions regarding loans and investment out of the funds of the company only to the Board of Director, however, this forced reservation does not apply to licensed Banks and Financial Institutions as well as the company with an objective to carrying out financial services. The said limitation on the delegation of authority, particularly to make loan and investment decisions, is not compatible on account of PE Funds. This limitation must be revised if PE Funds are to operate in Nepal.

INVESTMENT LIMIT

Companies Act restricts the companies to lend or invest in excess of -(a) 60% of sum of total paid up capital and free reserve, or (b)100% of the free reserves whichever is higher, however, the Companies with the objective to sell and purchase the securities are exempted from this restriction. PE Funds pools investment through public subscription, private placement or through other means and reinvest in carefully chosen targets. The amount pooled in the PE Funds at any instance are very much higher than the sum of the paid up capital and amount provisioned as free reserve in Annual Financial Statements. The restriction will force the Offshore PE Funds to hoard the money collected in the fund. It is not clear whether the Onshore PE Funds can organize as a Company with objective to sell and purchase securities. PE Funds should be recognized as a Company having objective to sell and purchase securities by way of clarification or notification.

BLACKLISTING

As per the NRB's provision of blacklisting of defaulter, the PE Funds as well as its directors and its appointee director in the targets will be blacklisted, if the investee companies receiving 15% or more of their equity capital defaults in loan repayment to the licensed banks and financial institutions in Nepal. The possibility of the chosen targets or companies being blacklisted for default in servicing debt cannot be out-ruled even if a great deal of precaution is/was employed while choosing the targets. While the PE Funds customarily invest in hundreds of targets, default by one or two of their investee companies will make the PE Funds blacklisted leaving no option but to shut down their entire business. The blacklisting

provisions at the present appear to be draconian for PE Funds. Revision in blacklisting norms is required to provide for a comfortable working environment for PE funds, considering the typical investment norms and practices of PE Funds.

DISPUTE SETTLEMENT

Offshore PE Funds investing in the portfolios of Nepalese companies have an option to choose the law governing their foreign investment agreement only when the amount of foreign investment is more than Rs. 500,000,000 (Five Hundred Million Nepalese Rupees). Given the fact that the arbitration process in Nepal are plagued with procedural delays and the issue of nationality bias, the prospective Offshore Funds willing to test the water in Nepal may not feel comfortable. The provisions in FITTA making the autonomy of the party to choose the governing law conditional or subject to the amount of inward foreign investment, seriously limits the SMEs and Venture Capital Undertaking's opportunity to receive the foreign investment.

RESTRICTIVE APPROACH IN TREATING HYBRID INSTRUMENTS

The existing law of Nepal is silent in providing any guidance regarding the treatment and permissibility of the foreign hybrid instruments. NRB has not prescribed any norms that would be applicable on raising foreign capital through debentures and hybrid instruments, till date. Absence of regulatory norms in Nepal should be understood as implied restriction as per the Nepalese Practice. The implied restrictions in raising the capital in foreign currency by way of debenture or through other hybrid instrument have limited the subscription options available to the Onshore PE Funds. NRB should prescribe the regulatory norms for the treatment of foreign hybrid instruments in order to allow the Onshore PE funds to pool the foreign capital to invest in the targets and portfolios of the Nepalese Companies.

EXIT

The PE Funds as a matter of custom has predetermined and short life span. Almost every of the PE Funds has the objective and strategy to exit from their targets upon the expiry of a fixed time. The successful operation of the exit strategy depends upon how friendly the regulatory environment for exit is. Unfortunately, the regulatory environment is not-so-friendly in Nepal. The exit from the targets will be very difficult for the PE Funds, unless, the existing onerous provisions on Security Law and Company Law of Nepal are relaxed in case of PE Funds, considering their typical nature for investment and limited lifespan. Some issues affecting the successful exit from the targets and possible ways to curb the difficulties are highlighted below:

DUPLICATION IN APPROVAL PROCEDURE

Exiting from the targets may not be difficult for Onshore Funds, but it is a very serious matter in case of Offshore Funds. Offshore PE Funds are required to obtain approvals, at least from - (a) DOI and (b) NRB before they can divest their investment, or repatriate the sale proceeds and dividends. The process for

obtaining approval is fraught with procedural delays and lack of coordination among the authorities and it can take more than two (2) months to complete even after strong persuasion and lobbying. The approval requirements *per se* and the procedural delays create a sense of funds being trapped in the targets once they enter. By exercise of control and the procedural delays, a lot of capital delay might actually be discouraged - those who are willing to come and invest to test the water might not do so fearing that strategic exit from the target might not be possible.

VALUATION NORMS

NRB's Notice dated May 29, 2012 states the requirement for the submission of valuation report of the assets and liabilities for the repatriation of the foreign investment. However, the NRB or other concerned authorities have not specified the valuation norms and method till the date. This has resulted in ambiguity in the choice of valuation method. In absence of specific valuation norms and methods, the NRB may object to the particular method of valuation with a drive to - (a) protect the foreign exchange reserve by claiming that the value of unit share is low if the other method of valuation was objected; and/or (b) to levy higher capital gain tax claiming that the value per unit of share will be higher if another method of valuation is used. Offshore PE Funds may not be able to implement its strategic interest to exit from the targets in a short time frame should the authority object to the particular method of valuation. The NRB and other authorities may coordinate in prescribing valuation method applicable for the repatriation of the divestment, dividend and sale proceeds.

RESTRICTION IN ISSUANCE OF SHARES AT PREMIUM RATE

Companies in Nepal cannot issue share in premium rate without having the track record of dividend distribution for a consecutive three years and without fulfilling other prescribed conditions. The said restriction will prohibit the Offshore PE Funds to exit from the targets by selling its holding at a premium price, even if the targets shows a promising future returns on the premium issued. While the said restriction may be justified in the pretext of protecting the interest of the retail investors, the justification does not hold good in all situation. The case of the PE Funds investing in the Research and Development sector can be taken as an example.

To facilitate the speedy exit of PE Fund, PE Funds investing in the Research and Development and other sectors having relatively higher gestation period should be exempted from the "minimum three year profit distribution requirement" while selling or opting to sell shares at a premium rate.

LOCK IN PERIOD

As per the SEBON rule on IPOs, All pre-IPO equity investors in non-financial institutions are unable to exit their investments for three years post-IPO, regardless of whether they are promoters or purely financial investors such PE Funds. Furthermore, a Company in Nepal cannot float its shares for public issuance until after three years from the date of operation. This together grosses a six (6) year of lock-in-period, a restrictive regulatory environment for the exit of PE Funds by offloading its shares floating public issue. PE Funds enjoy a relatively lesser lock in period in comparison to other investment vehicles almost everywhere. India can be taken as an example where the lock-in-period for AIF registered under

SEBI AIF Regulation, 2012 is only one (1) year. Lock-in-period should be reduced/ lowered particularly for PE Funds taking into account their limited lifespan.

REDEMPTION OF THE REDEEMABLE PREFERENTIAL SHARES

As per the Companies Act, 2006; Redemption of the shares previously issued can be done out of -(a) amount deposited in redemption fund which otherwise would be a distributable profit, or (b) money received from the share issued specifically for the purpose of redemption. The said condition implies that the company can redeem its shares only when it is in the state of profit. Due to said restrictions, PE Funds will not be able to exit from the investee company even by selling its preferential shares at a value less than the face value of the shares or the value of the shares at time of acquisitions. The restrictive conditions on redeeming the shares mean that the PE Funds can never exit from the investee companies in case the investee company is in loss.

Section 65 (5) of the Companies Act, 2006; has prescribed that the said restrictive conditions must be amended, allowing the investee companies to redeem the Preferential Shares issued to PE Funds from the amount available as paid up capital of the company or out of the amount collected by way of sale of investment and assets.

The provisions may be prescribed to require the investee company to adjust the value of the redeemable shares against assets and liabilities in case it is operating in loss or state of loss.

TAX MATTERS

TAXATION IN CHANGE OF OWNERSHIP

Section 57 of the ITA, 2002 provides that if the ownership of any entity changes by 50% or more within a period of 3 (three) years, then such entity will be deemed to have disposed of its assets or liabilities. Pursuant to Section 57 of the ITA, 2002, as a result of change of ownership by 50% or more-(a) the assets and liabilities of the entity will have to be evaluated at market price and the entity will be subject to tax on any gain amount (at the rate of the tax applicable on business income), and (b) the entity will not be able to carry forward the losses, and such other restrictions outlined in Section 57(3) of the ITA, 2002 will be applicable.

PE Funds will need to be provided specific waivers from the requirement of Section 57 of the ITA, 2002. It may be noted that the Government of Nepal had introduced targeted waiver for banks and financial institutions from the requirement of Section 57 to encourage merger and consolidation of financial sector.

DOUBLE TAXATION TREATY

Nepal has entered into double taxation treaty (the "DTA") with ten countries. In practice, however, the intended beneficiaries under the DTA are not able to receive the double taxation benefits provided under the DTA due to wrong application of the DTA by the IRD. The IRD should set-out the written guidance

on applicability of the DTA and situation where payments from Nepal will not be subject to the withholding tax requirement.

GUIDANCE ON TAXATION OF HYBRID INSTRUMENTS

The usage of hybrid instruments in Nepal is not common and their tax treatment does not have any legislative or regulatory guidance. ITA, 2002 provides substantial difference in treatment of interest and equity. The financial impact for re-characterization of any transaction from equity to debt or debt to equity is likely to be substantial. The IRD should set-out a written guidance with its view for tax treatment so as to provide predictability for use and structuring of the hybrid instruments which should meet the commercial objective of the investors and need of the investee entities.

FINALITY OF WITHHOLDING TAX

Section 92 of the ITA, 2002 provides final tax treatment for certain payments on which tax has been withheld. The payment falling under Section 92 of the ITA, 2002 are treated as finally taxed and no additional tax is incurred. The provision related to withholding of tax on capital gain tax is provided by Section 95A of the ITA, 2002. Section 92 of the ITA, 2002 which provides list of payments which shall be treated as final, does not include payments made under Section 95A. The VCFs should be provided finality of taxes.

CHAPTER ONE: INTRODUCTION TO PRIVATE EQUITY FUND IN NEPAL

1.1. UNDERSTANDING PRIVATE EQUITY

Private equity funds are investment vehicles formed to raise capital to make multiple investments in a specified industrial sector or geographic region. The private equity market provides capital to invest in unquoted companies. These investments may take the form of a purchase of shares from an existing shareholder (a buy-out if control is acquired) or an investment in new shares providing fresh capital to the investee company (development capital). Frequently both types of funding are provided in any given transaction. The term 'private equity' has no consistently-applied definition and is increasingly applied to any investor that is not quoted on a recognized financial market. In this report we employ the definition used within the established private equity industry. A structure of typical private equity fund is:

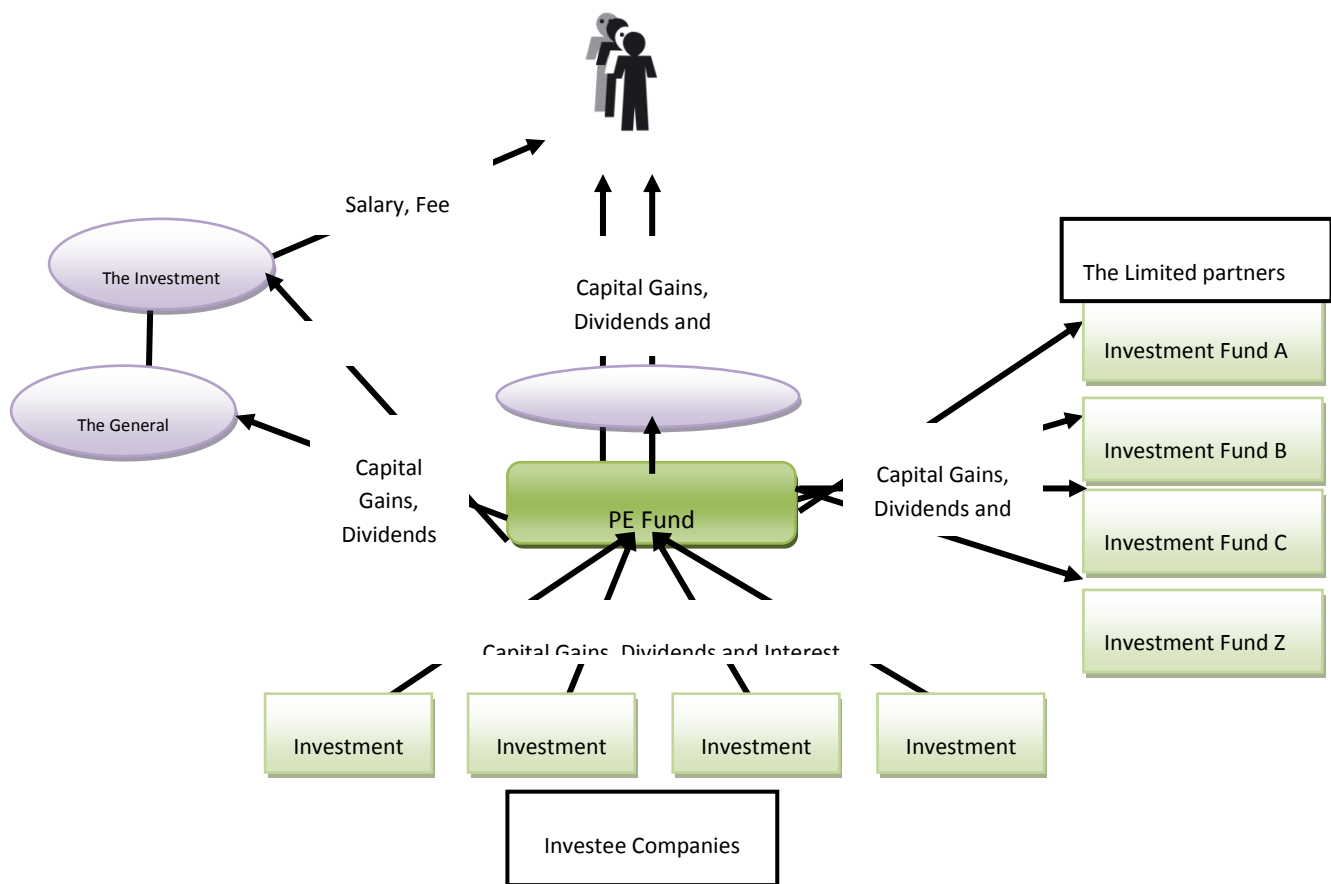


Figure 1: Structure of Private Equity Fund

A private equity fund is a form of ‘investment club’ in which the principal investors are institutional investors such as pension funds, investment funds, endowment funds, insurance companies, banks, family offices/high net worth individuals and funds of funds, as well as the private equity fund managers themselves. The objective of a private equity fund is to invest equity or risk capital in a portfolio of private companies which are identified and researched by the private equity fund managers. Private equity funds are generally designed to generate capital profits from the sale of investments rather than income from dividends, fees and interest payments. A private equity fund may take minority or majority stakes in its investments, though invariably it will be the latter in the larger buy-outs. At the same time that a private equity fund makes an investment in a private company, there is usually some bank debt or other debt capital raised to meet part of the capital required to fund the acquisition.

Private equity fund managers involve in activities such as:

- Raise funds from investors to make investments, principally in private companies.
- Source investment opportunities and make investments.
- Actively manage those investments.

- Realize capital gains by selling or floating investments.

In Nepal, private equity term has not been recognized as a form of institutional investment made either by domestic capital markets or by foreign investors. In Nepal, Foreign Investments have been defined and categorized by Foreign Investment and Technology Transfer Act (FITTA). FITTA, 1992 defines *Foreign Investment* as investment made by a foreign investor in any industry in the form of investment in shares (equity), reinvestment of earnings from investment in shares (equity) and investment made in the form of loan or loan facilities.

This report is an outcome of collaborative efforts of Pioneer Law Associates and Kriti Capital Investments to provide Dolma Development Fund insights on existing regulatory framework in Nepal, best practices and provide recommendation on broader policy and regulation changes for much needed Private Equity business to thrive in Nepal. Thus, the objectives of this report are to:

- Study the rules and regulations that have directly or indirectly created bottleneck for private equity/venture capital firms in Nepal.
- Understand, analyze and determine best practices in international context with special focus on India and other relevant South Asian Countries.
- Review the regulations related to initial public offerings (IPOs).
- Understand barriers to entry and exit in the development of investment friendly market for PEs in Nepal.
- Highlight the need of Private Equity business in Nepal and recommend on required regulatory changes to create Private Equity friendly regulatory environment.

The report is structured in the following way: Chapter One provides basic information on Private Equity Market, participants and PE in Nepal. Chapter Two discusses Entry options for Private Equity in Nepal with special reference to entry options in India, Sri Lanka and Bangladesh. Chapter Three reviews the operation aspects of PE whereas Chapter Four discusses the available exit strategies for Private Equities with special reference to exit options in India. Chapter Five provides insights on Tax aspects of Private Equity and final chapter concludes the report with list of key issues and recommendations.

1.2. PRIVATE EQUITY MARKET IN NEPAL

The introduction of Foreign Investment and Technology Act, 1981 and the subsequent Industrial Policy developed a proper framework for foreign investment in Nepal. Investment Promotion meeting was held in 1984 to promote foreign investment and to create awareness on investment opportunities in the country.

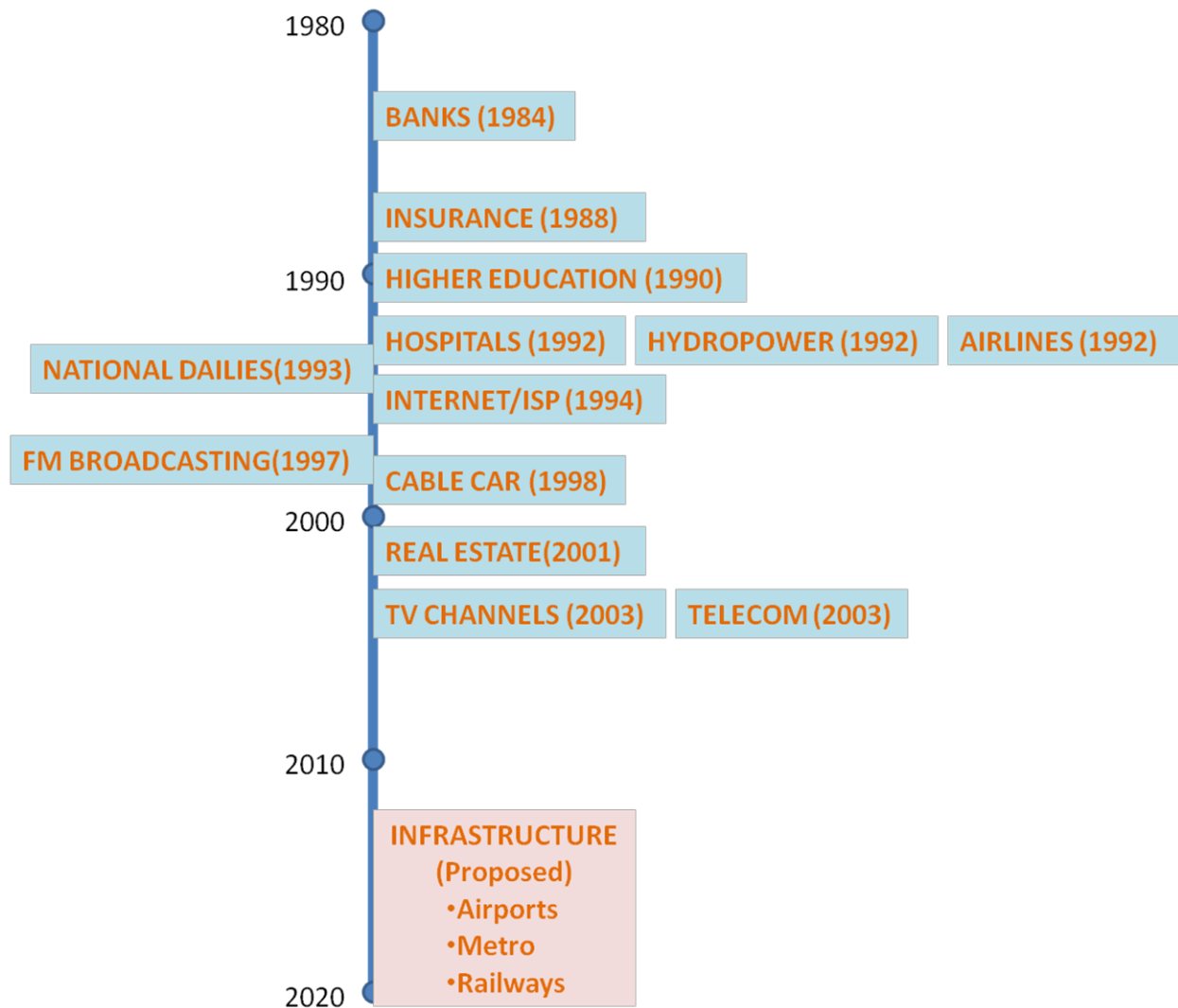
Nepal Investment Forum was organized in 1992 in Kathmandu, which helped attract foreign investors in Nepal. This was further enhanced by the promulgation of Foreign Investment and Technology Transfer Act, 1992 (FITTA) and Industrial Enterprises Act, 1992 (IEA), which sought to develop one window policy to ease the foreign investment process. National five-year plans too promoted foreign investment in the nation.

The foreign investors were allowed to invest in any industry up to a prescribed limit except in the pre-determined twenty-one sectors. The sectors with considerable foreign private equity investment participation in Nepal were:

SECTORS	COMPANIES WITH FOREIGN INVESTMENT		
Financial Services	Standard Chartered Bank	Nabil Bank	Everest Bank
	Nepal Bangladesh Bank	Himalayan Bank	United Finance
	International Leasing & Finance	Sagarmatha Insurance	United Insurance
Manufacturing	Asian Paints Nepal	Unilever Nepal Ltd.	Pepsi Cola
	Vashuling Sugar & General Ind.	Gorkha Brewery P. Ltd	Dabur Nepal Ltd.
Infrastructure	Bhote Koshi Power Co.	Himal Power Co	Panda of Nepal
	Statcraft Anlegg Nepal P. Ltd		
Export-oriented	Nepal Bayern Electric	Nara International	Male Fashions
	Trikumar Garment Industry	Shakti Carpet Service	
Tourism	Hotel Himalaya	Hokke Hotel (Lumbini)	Monal Resort
	Taini International Resort		
Aviation	Himalayan Helicopters	Dynasty Aviation	Lumbini Airways
	Balloon Sunrise Nepal		
Telecom	Ncell	UTL	

Source: NRB, Foreign Exchange Department

Following timeline shows the entry of private equity investment in Nepal.



Source: Compiled by author through various sources.

Figure 2: Timeline of Entry of Foreign Investment in Nepal

In Nepal, the concept of private equity fund is fairly new. The first local private equity fund was Surya Equity Fund, managed by Soaltee Group (Owner/Manager of Solatee Hotel Ltd.). Surya Fund is an investment management company, intending to establish itself as the vehicle for investment and capital appreciation for the prospective investors.

Beside Surya Equity Fund, there have been few companies incorporated as a private company with the objective of operating like a PE Fund does. But, the active roles of such companies are yet to be seen in the market. As the first international private equity investment, Dolma Impact Fund I has been initiated. The Fund is being established with support from the UK Department for International Development (DFID) to generate private sector-led growth and jobs alongside positive social and environmental impact in Nepal.

1.3. PARTICIPANTS OF THE PRIVATE EQUITY

There are two parties involved in every corporate transaction: those acting with or for the purchaser, and those acting with or for the owners of the Target Company and shareholders. In a private equity fund the key figures on the purchaser's side are the private equity fund that will invest in the transaction and the investment bankers who will lend in support of the deal. Partners in PE Fund are institutional and high-net-worth investors in a fund organized by PE Fund, as opposed to investing directly in the firm. Investors sign investment contracts that lock up their money for certain duration; generally 5 to 10 years. Partners commit to provide capital over time, rather than a single amount upfront. The draw on this capital depends on when investment opportunities are identified. As a result, it may be a number of years after the original commitment of capital before all of the funds are drawn down.

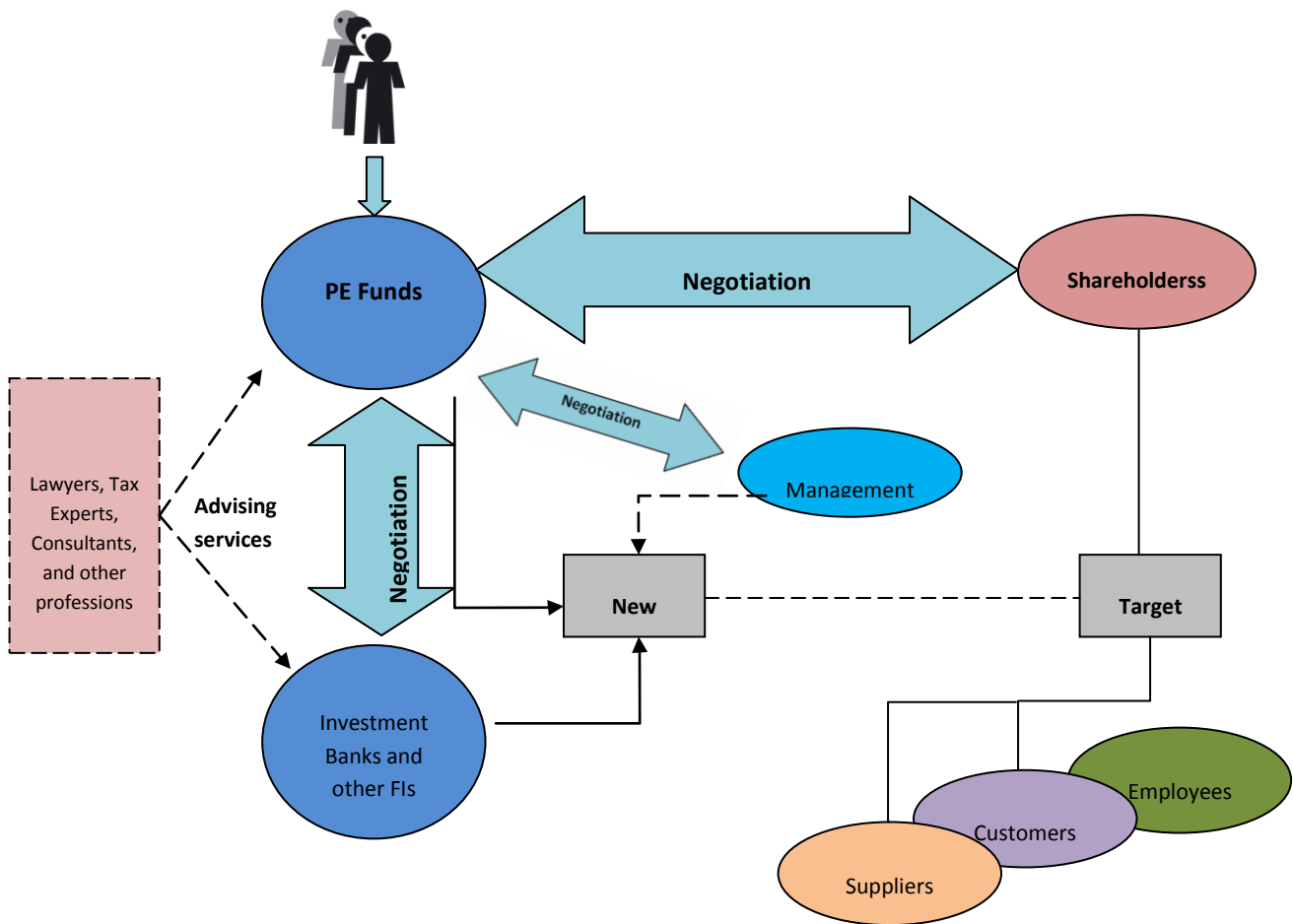


Figure 3: Typical participants in PE Funds

The PE Funds basically selects the target company with the assistance of investment banks and other advisors, negotiates the acquisition price, secures debt financing, completes the acquisition or investment, may be involved in the board of directors and manage the company either through existing management or new management, makes major strategic and financial decisions, and decides when and how to exit from the investment. Investment banks plays major role in private equity. They introduce potential acquisition targets to PE, help negotiate the acquisition price, assist in securing loans, and assist in exit of the investment.

On the target's side are the shareholders who are generally seeking to maximize the value they receive from any sale. They will be represented by the management of the business or independent advisors or both to negotiate with the PE Funds. The role of management varies based on the nature of the investment. They may be part of the group seeking to purchase the business and therefore be aligned with the private equity funds which is also known as inside buy-out or management buy-out. Alternatively, the private equity fund may be seeking to introduce new management if they successfully acquire the business which is also known as outsider buy-out or management buy-in.

1.4. GOVERNANCE REGIME AND REGULATORS IN NEPAL

Nepalese legal system is a mixed legal system largely influenced by the Common Law and Hindu Legal System. Constitutional supremacy and independence of judiciary are recognized and guaranteed by the Constitution of Nepal. Disputes relating to civil and criminal matters are resolved through three tiers of court (i.e. District Court, Court of Appeal and Supreme Court), quasi-judicial authorities, tribunal and the panel of arbitration chosen by the parties to disputes. There are 75 District Courts, 16 Courts of Appeal and 1 Supreme Court.

Nepal has a written constitution. However, the existing constitution is the "Interim Constitution of Nepal, 2007 (2063)" which is expected to be replaced by the new constitution promulgated by the Constituent Assembly of Nepal.

The Parliament constituted by the representatives of the people through election is tasked to pass law. In most cases, the bill is brought to the Parliament from the Ministry of Law, Justice and Parliamentary Affairs and relatively lesser numbers of bills are tabled at the Parliament by individual Members of Parliament. Activities like seeking opinion from public, consulting with experts; discussion with the stakeholders in respect to contents of Bills before tabling them at the Parliament are not widely practiced in Nepal. In general, drafting, structuring and formalizing of the bills take place inside the Ministry of Law, Justice and Parliamentary Affairs.

Unlike India and other jurisdictions, there is no special legal regime in Nepal to regulate Private Equity Funds (PEFs) or Venture Capital Funds (VCFs), neither is there a single regulator. For instance, In India, VCFs and Foreign VCFs are classified as Category I Alternative Investment Funds (Category -I AIF) and are regulated under SEBI Alternative Investment Funds Regulation, 2012. As Nepal does not have a separate and special regime to regulate PEFs or VCFs, different legislations will apply to the creation and operation of the PEFs or VCFs and their investments in the portfolios.

The laws that are specifically and generally applicable to the PEFs or VCFs are listed below. However, the list is indicative and not exhaustive as such funds may be subject to multiple regulations or compliance as set out under other laws of Nepal.

1.4.1. SPECIFIC LAWS AND REGULATORS

Specific Law	Scope	Regulator	Remarks
Foreign Investment and Technology Transfer Act, 1992 ("FITTA")	<ul style="list-style-type: none"> • Lists out the sectors open for foreign investment. • Defines the permissible forms of investment. Guarantees the rights of the foreign investors such as right to repatriate the return and investments, visa matters. • Defines the governing laws and mechanisms of dispute settlement. 	<ul style="list-style-type: none"> • Department of Industry ("DoI") in case of foreign investment below Two Billion Rupees. • Industrial Promotion Board ("IPB") for foreign investment above Two Billion Rupees. • Investment Board for the foreign investment in the specified projects under the Investment Board Act, 2012. 	<p>FITTA will be applicable to offshore funds while making investments in the portfolio companies in Nepal and repatriation of the returns and investments. The FITTA will also be applicable to create the onshore funds with the foreign investments and repatriation of the returns and investments by such onshore funds. However, the FITTA will not apply to the onshore funds (such as investment companies) with full local ownership.</p> <p>FITTA does not apply to foreign investments in those businesses which are not classified as an "industry" under the Industrial Enterprise Act, 1992. For example, financial services such as banking and insurance businesses do not fall under the category of "industry" under the FITTA, 1992 and as such any foreign investments in such sector of business are separately governed by the concerned regulator/line ministry.</p>
Foreign Exchange Regulation Act,	<ul style="list-style-type: none"> • Regulates the inflow and outflow of foreign 	Nepal Rastra Bank ("NRB") (the	FERA will be applicable to offshore funds while making

1958 ("FERA")	currency	Central Bank)	<p>investments in the portfolio companies in Nepal and repatriation of the returns and investments. FERA will also be applicable to create onshore funds with foreign investments and repatriation of the returns and investments by such onshore funds. However, FERA will not apply to the onshore funds (such as investment companies) with full local ownership.</p> <p>Rules on inflow and outflow of foreign currencies are regulated and implemented by Nepal Rastra Bank through a series of directives, circulars and notifications issued by Nepal Rastra Bank from time to time.</p>
<p>• Provides approval for equity and loan investments by the foreign investors</p> <p>• Regulates the repatriation of return and investments of foreign investors.</p>			
<p>Securities Laws</p> <p>Securities Act, 2007</p> <p>Securities Exchange Rules, 2007</p> <p>Security Issue and Registration Regulation, 2008 and Security Issue and Registration Directive, 2008</p> <p>Collective Investment Fund</p>	<ul style="list-style-type: none"> • Exit of PEFs through initial public offerings. • Lock-in period applicable to the promoters and other categories of shareholders of the listed companies • Regulates Trustee (Onshore Trustee), Project Manager (Onshore Fund Manager) and Depository. 	Security Exchange Board of Nepal (SEBON).	<p>The provisions of the Securities Act and other relevant securities legislations will apply to the PEFs and VCFs only where the portfolio companies are listed companies. If the fund manager of such fund is a local entity, then the provisions of the Collective Investment Fund (Mutual Fund) Regulation will apply to such fund manager.</p> <p>Collective Investment Fund in Nepal are not allowed to make loan and equity investment in start-up undertakings start up undertakings and unlisted securities has not been recognized as the permissible</p>

(Mutual Fund) Regulation, 2007			sector of investment for Collective Investment Fund by the Regulation.
			While the Securities Act, 2007 prescribes a broader norms on Security Exchange laws in Nepal, such broader norms are administered and implemented through regulation, byelaws, notifications etc issued by SEBON under Security Act, 2007.
Income Tax Act, 2002 ("ITA 2002"), And Income Tax Rules 2003 (the "ITA Rules 2003")	<ul style="list-style-type: none">• ITA, 2002 deals with the levying of tax on the income of persons (legal and natural), and of body corporate.• ITA, 2002 provides for the tax benefits and exemptions to the investors investing into certain prioritized sectors. For example, while the regular corporate tax rate is 25%, hydropower projects are taxed only at the rate of 20%.• The withholding taxes are deducted at the source of the payment as royalties, dividend, service fees, remuneration to employee, rent, interest etc.	Inland Revenue Department	<p>PEFs and VCFs and the tax treatment of PEFs and VCFs are similar to other entities.</p> <p>Provisions of the ITA, 2002 mainly apply to offshore funds on repatriation of the returns and investments and also tax benefits under the double taxation treaty, if any.</p> <p>Provisions of the ITA, 2002 apply to onshore funds on the overall aspect of income from the portfolio companies, distribution of such return to the investors and exit and divestment.</p>

Value Added Tax Act, 1997 (2053) (the "VAT Act") and

Value Added Tax Rules, 1997 ("VAT Rules")

- Provides for collection and payment of the value added tax on the goods and services that are subject to VAT.

The provisions of the VAT Act and VAT Rules generally do not apply to onshore or offshore funds. However, the same will apply to the portfolio companies if such portfolio companies conduct the transactions which are subject to VAT under the VAT Act and VAT Rules.

2.4.2. GENERAL LAWS AND REGULATORS

General Law	Scope	Regulatory	Remarks
Companies Act, 2006	<ul style="list-style-type: none"> Provisions regarding formation of the companies, operation and dissolution. Sets out the rights and redress available to the shareholders Sets out the duties and liabilities of the directors. 	Office of the Company Registrar (" OCR ")	<p>Provisions of the Companies Act apply to the creation, operation and exit of onshore funds and portfolio companies.</p> <p>Provisions of the Companies Act will also apply to offshore funds in relation to the rights and redress of the offshore funds as shareholder of the portfolio companies and representation to the board of directors of the portfolio companies.</p>
Contract Act, 2000 ("Contract Act")	<ul style="list-style-type: none"> Sets out the rules for formation, performance, breach and remedy of the contracts. Provides the rules for autonomy of the parties of the contract Also covers the rules for special types of contracts such as sale of goods, etc. 	Not Any	If Nepalese Law is provided as to be governing law on contracts and agreement concluded by PE Funds, provisions of the Contract Act will be applicable in the event of dispute.
IEA, 1992	<ul style="list-style-type: none"> Classifies the industries into various types on the basis of-(a) investment in the fixed assets, and (b) sector of business. The classification based on the sector of business will be relevant for the purpose of the foreign investments and; (c) large scale industries. Provides provision for the 	<p>Department of Industry</p> <p>Industrial Promotion Board</p>	

concessions and benefits to industries in priority sectors.			
BAFIA, 2006	<ul style="list-style-type: none"> • Regulation of Banking and Financial Transaction. • Defines "Financial Transaction" primarily as a deposit and lending transaction. 	Nepal Rastra Bank	Under BAFIA, 2006, only licensed banks and financial institutions can carry out the "financial transactions" under Section 47 of the BAFIA. Any loan investments by the onshore funds in the portfolio companies may be viewed as "financial transactions" by Nepal Rastra Bank.
NRB Act 2002	<ul style="list-style-type: none"> • Establishes NRB as regulator of bank and financial sectors. • Provides that approval from Nepal Rastra Bank is required for providing loans. 	Nepal Rastra Bank	Any loan investments by offshore or onshore funds will require approval from Nepal Rastra Bank.

CHAPTER TWO: ENTRY OF PRIVATE EQUITY FUND

2.1. ENTRY OPTIONS: ONSHORE VEHICLE AND OFFSHORE VEHICLE

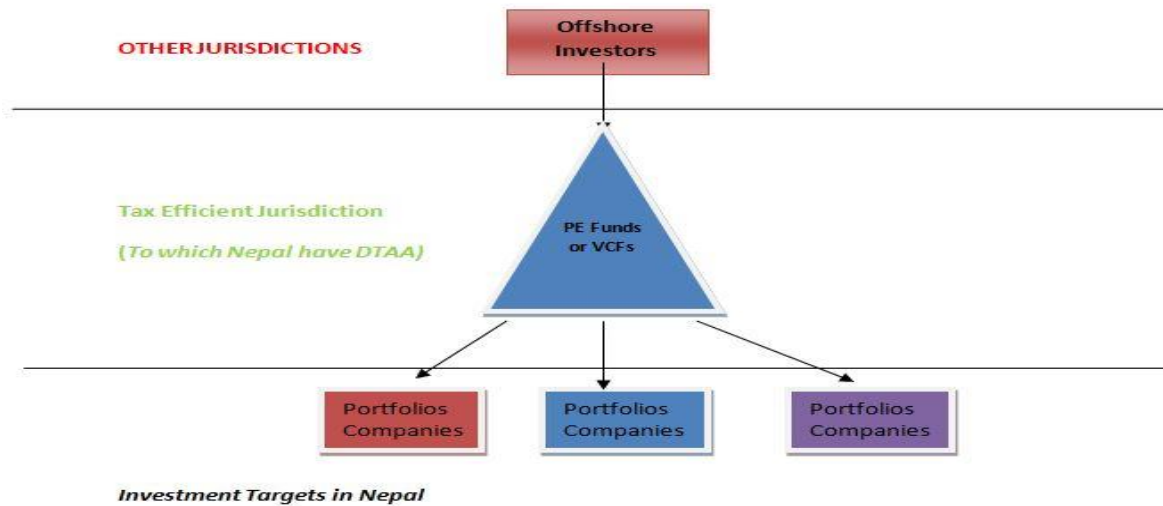


Fig-1 Structure- Typical Offshore PE Funds or VCFs making equity investment in Nepalese Portfolios.

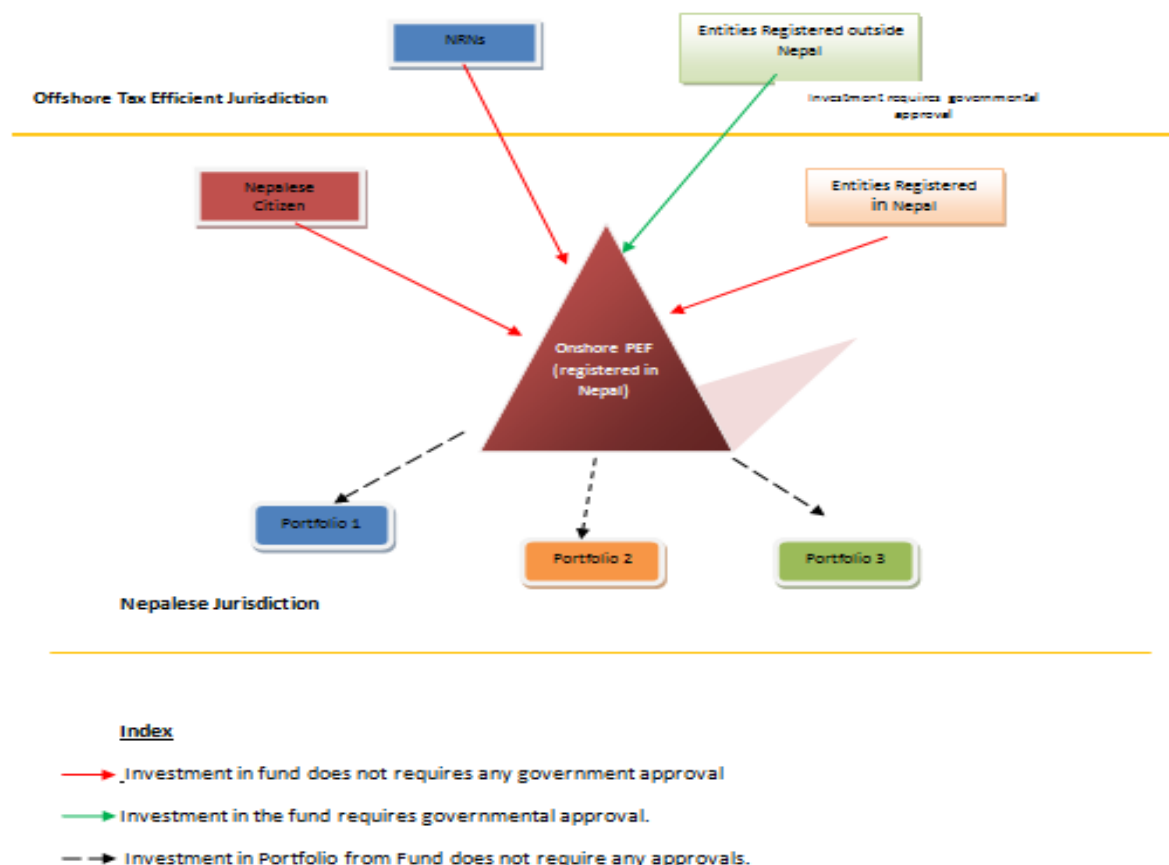


Fig-2: Typical Onshore PEFs investing in Nepalese Portfolios.

Although there is no specific regulatory framework to deal with the PEFs in Nepal, the PEFs or VCFs can be set up in Nepal like other regular business entities.

The PEFs or VCFs can take of any of three forms as follows:

- Offshore Funds:** PEFs or VCFs may be created outside of Nepal and such fund may invest in various portfolio entities in Nepal;
- Foreign Onshore Funds:** PEFs or VCFs are created in Nepal under foreign investments and such foreign onshore funds invest in different targets in Nepal. Such foreign onshore funds can be fully or partly owned by the foreign investors;
- Domestic Onshore Funds:** Onshore funds set up by Nepalese nationals or entities registered in Nepal invest in various targets in Nepal. Such domestic onshore funds are fully owned by the local investors in Nepal and operate like an investment company. Thus, there is no requirement for approval for foreign investment.

Unlike India and many other jurisdictions in Asian Region, the law accords no special benefits and incentives for PEFs or other such investment vehicles. For example, In case of India, SEBI registered Foreign Venture Capital Funds (FVCFs) can freely price the value of shares at the time of exit whereas

other non-VCFs entities are required to evaluate the price of shares either on the DCF Method of Valuation or on the basis of method employed by SEBI registered Merchant Banker.

2.2. SETTING UP OF PRIVATE EQUITY FUND

2.2.1. OFFSHORE PEFS

2.2.1.1. APPROVALS REQUIRED

Any investment by offshore funds in any target/portfolio companies in Nepal is considered as "foreign investments" for the purpose of FITTA, 1992 and FERA, 1962² and is subject to approvals from the relevant government authorities. Approvals from at least 2 different regulators will be required for offshore funds to invest in the targets in Nepal:

- (a) DoI/IPB/Investment Board, and
- (b) Nepal Rastra Bank.

Approval from DoI/IPB/Investment Board will depend on-(a) amount of the foreign investments, and/or-(b) nature of the project/business of the portfolio companies. Following table sets out the relevant authorities for granting the approval:

Approving Authority	Amount of the foreign investment/project	Relevant Laws
DoI³	DoI, upon its own, approves the foreign investment in projects/ industry with fixed assets less than NRs. 2,000,000,000. (Two Billion Nepalese Rupees).	Section 3 of FITTA, 1992.
IPB⁴	IPB decides regarding the approval	Section 3 (3) of FITTA, 1992.

² Section 2 (a) of the FITTA, 1992 defines "foreign investment" as investment by foreign investor in (a) Shares, (b) reinvestment of the dividend earned from investment in shares, and (c) loan investment in Nepalese Industry. Section 2 (g1) of the FERA, 1962 defines "foreign investment" as investment by foreign investor in any firm, company or organization registered in Nepal in the form of (a) Shares (b) Deposits (c) reinvestment of the investment return or dividend (d) loan or loan facility.

³ DoI is an authority headed by Director General of the Department of Industry and it is tasked with the responsibility to, inter alia, provide foreign investment proposals to invest in industries having fixed assets of less than NRs. 5,000,000,000 (Five Billion Nepalese Rupees). However, The DoI can approve the foreign investment proposal only if the Industrial Promotion Board has decided to grant said foreign investment approval, in case the industry receiving foreign investment has fixed assets with value more than NRs. 2,000,000,000 (Two Billion Nepalese Rupees).

	for foreign investment in the projects/ industries with fixed assets above Rs. 2,000,000,000 (Two Billion Nepalese Rupees).	As a matter of law, IPB is required to decide or approve foreign investment in industries having fixed assets with value of more than NRs. 500,000,000. However in practice, approval for the foreign investment in projects/industries having fixed assets of more than NRs. 2,000,000,000 (Two Billion Nepalese Rupees) is decided by IPB.
Investment Board⁵	Foreign Investment in projects listed under Section 9 of Investment Board Act, 2011 (" IBA, 2011 "). Section 9 of IBA, 2011 includes, among others, investment in the large infrastructure projects, hydropower with installed capacity of 500 MW or more, medical colleges, hospital or nursing homes having more than 300 beds, etc.	Section 9 (1) of IBA, 2011.

FITTA, FERA or Investment Board Act does not provide for blanket or single approval for offshore funds for investment in multiple portfolio companies. At present, governmental approvals are required at least for – (a) each investment by offshore fund in each portfolio companies in Nepal, (b) each increase of investment of offshore fund in each portfolio companies in Nepal. The steps and timeline for obtaining investment approvals in Nepalese Targets is presented in Annex 3 and Annex 5.

Similarly, the said laws do not provide for automatic approval route allowing foreign investors including Offshore PEFs to invest in Nepalese Portfolio entities without being required to obtain governmental approvals. Most of the jurisdictions encouraging Offshore Investments in Domestic

⁴ IPB is a high level board headed by the Minister or State Minister of Industries whose decision is required for making foreign investment in an industry having fixed assets of more than NRs. 2,000,000,000 (Two Billion Nepalese Rupees).

⁵ Investment Board is a high level board headed by the Prime Minister which provides approval for making investments (both, domestic and foreign investment) in the projects listed on Section 9 of Investment Board Act, 2011.

Ventures in certain prioritized sectors allow the Offshore Funds to come and invest through automatic approval route. For instance, in India, foreign investors including offshore PEFs investing through automatic approval route in Indian Portfolios or ventures of certain prioritized sectors recognized by FDI Circular⁶ are free to invest in targets and portfolios of such sectors without being required to obtain any investment approval in India. They are only required to notify the investment details post investment.

2.3. PERMITTED SECTORS

As a matter of general rule, foreign investors can only invest in targets in industrial sector and not in trading sector. As Offshore PEFs will also be taken as Foreign Investor under the Nepalese Law, their choice of targets should (a) fall within what is recognized as industrial sector under IEA, and (b) be open for foreign investment as listed under FITTA. In addition to the negative list and sectoral caps, the concerned authorities frequently object to provide foreign investment approvals specifying policy (published and unpublished policy) reasons. The approach in granting approvals is highly ad-hoc and interpretation and implementation of policy requirement is highly inconsistent. The negative list of sectors/ target prohibited for foreign investment is presented in Annex 2. The negative list of sectors/ target prohibited for foreign investment is expected to be redefined upon the entry into force of the Draft Foreign Investment and Technology Transfer Act (The "Draft FITTA"). The negative list for foreign investment proposed under Draft FITTA is presented in Annex 2A.

In addition to the above negative list, Offshore PEFs cannot invest in Nepalese portfolio entities crossing sectoral caps or limit (sectoral limits defined in term of ownership interest in portfolio entities) of foreign investment prescribed for different sectors under different sectoral policies and regulations. The existing sectoral caps in some of the industries are presented in the table below:

Sectors	Ceiling of the foreign investments
Telecommunication	80%
Insurance	70% (for life insurance)
Air passenger service domestic	49%
Air passenger service international	80%
Consultancy services like accounting, management services, legal	51%

⁶ Reserve Bank of India : Foreign Direct Investment Circular, 2013.

Note: The above list of sectoral caps (limit) is indicative and not exhaustive.

The above lists of sectoral caps are expected to be re-marked and redefined upon the entry-into-force of Draft FITTA. The sectoral cap for foreign investment proposed under the Draft FITTA is presented in the table below:

Sectors	Ceiling of the Foreign Investment
Hotels and Lodges	80%
Travel Agency and Tour Operators	51%
Account and Audit Service	51%
Bank and Financial Sectors	66%
Veterinary Sector	51%
Communication Sector	80%
Research and Development	51%
Construction and Construction Related Engineering	51%
Retail Service	51%
Education Service	51%
Environmental Service	51%
Health Service	51%
Transportation Service	51%

On one hand, the pre-admission regulations on foreign investment by imposing of negative lists may have its justification on the State's inherent concern to make productive and strategic sectors of economy free from the control of foreign investors. On the other hand, the restrictive approach adopted by the Government authorities has virtually limited the permitted sectors of investment by offshore funds. Also, ad-hoc and inconsistent application of the laws by the government authorities have added uncertainty for the PE funds.

The Draft FITTA has proposed to introduce a general Minimum Capitalization Requirement ("MCR") of USD 200,000 (Two Hundred Thousand US Dollar) for foreign investment in every

sector and special MCR for specific sectors such as, Hydropower⁷, Transport and Infrastructure Development⁸, Agriculture and Herb Processing⁹, Hotels¹⁰, Mining and Production Sectors¹¹.

2.4. INVESTMENT OPTIONS

Offshore Investment Funds can make both loan investment and equity Investment in Shares (Ordinary and Preferences) in Nepalese Portfolios. However, investment through equity linked instrument like compulsory convertible debentures, optional convertible debentures are not practiced and the Central Bank has not set any criterion and requirements to approve investment through equity linked instruments either. The requirement as to the documentation in obtaining the investment approval from NRB is presented in Annex 4 and Annex 5.

2.5. PERMITTED FORMS OF OFFSHORE FUNDS AND PORTFOLIO

2.5.1. PERMITTED FORMS OF OFFSHORE FUNDS

The IEA, 1992 as well as FITTA, 1992 does not require the foreign investors to be registered/incorporated in a particular form in their home jurisdiction in order to be eligible to invest in Nepal. FITTA 1992, under Section 2 (d) and FERA, 1962 under Section 2 (g3) together defines "Foreign Investor" as any foreign persons, firm, company or body including foreign government and international agency making foreign investment and technology transfer in Nepal. Pursuant to the definitions of "Foreign Investors" in said Section(s) of said Act(s), it is clear that, anyone making foreign investment and technology transfer in Nepal is foreign investor for the purpose of the Act and there is no compulsion for foreign investor(s) to be organized in a particular form in order to be eligible to make investment in Nepal.

PE Funds willing to invest in (a) listed securities (b) government bonds (c) bank deposits (d) money market instrument are allowed to be organized as Collective Investment Fund under Collective Investment Fund (Mutual Fund) Regulation, 2010.

⁷ Under Draft FITTA, only those hydropower projects that have installed capacity above 30 MW are open for foreign investment.

⁸ The Minimum Capitalization requirement for foreign investment in Transport and Infrastructure Sectors is set as 10,000,000 USD.

⁹ The Minimum Capitalization Requirement for foreign investment in Agro and herbal processing industry, export promotion industry and import substitution industry is set as 2,000,000.00.

¹⁰ Under Draft FITTA, only those hotels which are ranked above 3-Stars are open for foreign investment.

¹¹ The Minimum Capitalization Requirement for foreign investment in Mining and production industries is set as USD 20,000,000.

However, foreign investment in the Nepalese Portfolio of Banks and Financial sector and Insurance sector is permitted only when the foreign investor is a registered Bank or Financial Institution or Insurance Company (as the case may be) in the home jurisdiction. This organization requirement is likely to limit the scope of Offshore PE Funds in Nepalese targets belonging to Banking and Insurance sectors.

2.5.2. PERMITTED FORMS OF PORTFOLIOS

IEA or FITTA does not prescribe any specific criterion for a Nepalese entity, in particular, in terms of its form or organization to be eligible to receive foreign investment. However, considering the typical nature of PEFs investment, some practical issues may arise. For example, the equity investment is not possible in the entity organized as sole-trading concern or Partnership Firm. In addition to this, the Limited Liability Partnership (s) (LLPs) is not recognized under Nepalese Law. Thus, in practice, the target portfolios must be organized in the form of Limited Liability Company for it to be able to receive equity investment.

2.6. ONSHORE PEFS

2.6.1. APPROVAL REQUIREMENTS

Onshore PEFs can be registered in two ways – (a) registering an Onshore Fund under foreign investment, (b) registering an Onshore Fund under direct investment of resident Nepalese Citizen, Non-resident Nepalese ("NRNs" foreign citizen of Nepalese Origin and/or Nepalese citizens residing abroad) and entities incorporated in Nepal.

Foreign Investment in Onshore Funds or PEFs registered in Nepal should be routed through the governmental approval route and the steps, timeline and documentary requirement are the same as that of investment from Offshore Funds. However, in the case of Onshore Funds, exchange control approvals are not required for direct investment from Nepalese Citizen, NRNs and other entities registered in Nepal. FITTA or IEA does not impose any restriction on investment by non-foreign investor. Technically, Onshore Funds registered in Nepal should be allowed to freely choose its target portfolios. However, in practice, the Onshore Entities controlled by the foreign investors are not allowed to invest in the sector not open for foreign investment. For example, the Onshore entities controlled by foreign investors are not to invest in trading sector as well as other sectors which are not recognized as industrial sector under IEA. There are also various instances where the authority has restricted the Onshore Funds established on Foreign Investment to invest on the targets falling under negative list.

2.6.2. PERMITTED FORMS OF ORGANIZATION

As a matter of law, there is no compulsion for Onshore PEFs to be organized in a particular form. As there is no specific legislative guidance on the regulation of PE Funds, legally; the Onshore PE Funds can get themselves organized in any form. However, a gazette notification has been published on May 16, 2011, which provides that activities such as making investment and providing consultancy shall be done through 'Investment Company'. Though much details as to the requirements for such Investment Company has not made public till date, it is understood that the said gazette has contemplated 'Investment

Company' will have similar nature like of PE Funds. The term 'Company' means a public limited company or private limited company for the purpose of Companies Act, 2006.

Unlike India, USA and other jurisdictions with well developed legal regime on FEFX, the organization of the Private Equity Funds cannot take in the form of Trust or Limited Liability Partnership. For instance, in India PEFs or VCFs can be registered as a Trust, Company; recently, Limited Liability Partnership (LLP) has also been recognized as permissible form of organization.

As both the PEFs (offshore or onshore) usually invest in the equity of portfolios or target, being incorporated as a Limited Liability Company is only choice available if the PE Funds wish to make equity investment, however, such compulsion is not applicable in case PE Funds wish to make loan investment only.

The investment options available to Onshore Funds and Offshore Funds under the existing Nepalese Laws are compared on the table below:

Basis of Comparison	Offshore Fund	Onshore Fund
Requirement of Regulatory Approvals	Regulatory Approval will be required for—(a) each investment in the targets (b) sale of each investment in the target, and (c) repatriation of dividend or investment of such target.	Regulatory approvals will be required only for the formation of an Onshore Vehicle. No Regulatory approvals will be required for investments in the targets. The regulatory approvals will be required only for – (A) the sale of the interest of the Onshore Vehicle, and (B) on making repatriation of the dividend distributed by the Onshore Vehicle.
Forms of the Investment in the Target.	<ul style="list-style-type: none"> Investments can be made in the targets in the form of both equity and loan. The loan investment may be subject to such regulatory terms such as rate of interest that can be charged and also policy that NRB adopts from time to time. 	Investment can be made only in the shares of the target. Investment in the form of loan may be prohibited under Bank and Financial Institutions Act, 2006 as carrying out the financial transaction is reserved only to licensed institutions (which may be taken as carrying financial transaction under BAFIA)
Permitted Sectors of Investment	The Offshore Vehicles will only be able to invest in those targets which are open for foreign investors i.e. businesses/ targets not falling under the negative list of FITTA, 1992, and within the limit of sectoral cap foreign investment	Technically, investments made by Onshore Funds in the targets should not be construed as 'Foreign Investment'. However, there are some known instances in the past, where regulatory authorities had prohibited onshore business vehicles set-up under foreign

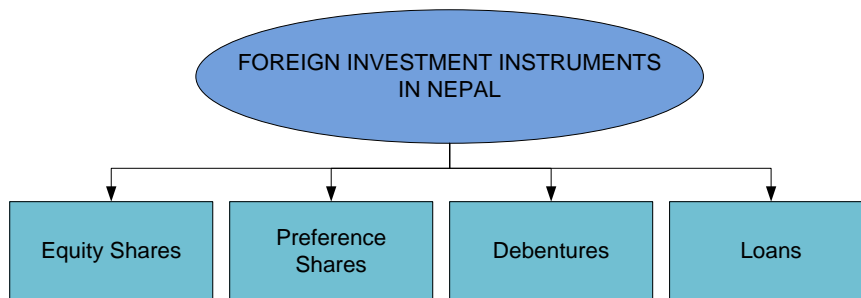
	<p>in the particular business.</p>	<p>investment from investing into trading sectors and other prohibited sectors.</p> <p>However, after gazette notification of May 16, 2011 which included the Investment Company formed with an objective to carry investment activities and provide consultancy in Service Based Industry. On the basis of this, it is understood that Offshore Fund can be registered in the form of Investment Company.</p>
Permitted Form of Vehicle	<p>No statutory restrictions in terms of permitted form of investment vehicle, however, may be dependent on inconsistent policies consideration to be applied by concerned authority.</p>	<p>Normally, foreign investment is not permitted in the sector which has not been recognized as an Industrial Sectors under IEA. Recent amendment of IEA on May 16, 2011 has included and thereby recognized Investment Company with the objective to carryout investment activities, infrastructure development activities and counseling activities as Industrial Sector. From the wording of the said gazette notification it is understood that the PE Funds should be organized in the form of Limited Liability Company registered with DoI as Investment Company.</p>

2.7. DEFINITIONS OF RELATED TERMS

The definition of the related terms such as securities, foreign investment and foreign investors as per Company Act, and Securities Registration and Issue Regulations is provided in Annex 6.

2.8. PERMITTED FORMS OF INVESTMENTS

Companies in Nepal can raise capital through shares and debt. Shares can be in the form of equity shares and preference shares. Shares of common stock or equity are the fundamental ownership units of the corporation. The Companies Act, 2063, Section 30, allows companies to issue various classes of shares with different rights attached thereto that shall be stated clearly in its MoA and AoA. Preferred equity represents equity of a corporation, but it is different from common stock because it has preference over common stock in the payment of dividends and in the assets of the corporation in the event of bankruptcy. Preference means only that the holder of the preferred share must receive a dividend before holders of common shares are entitled to anything.

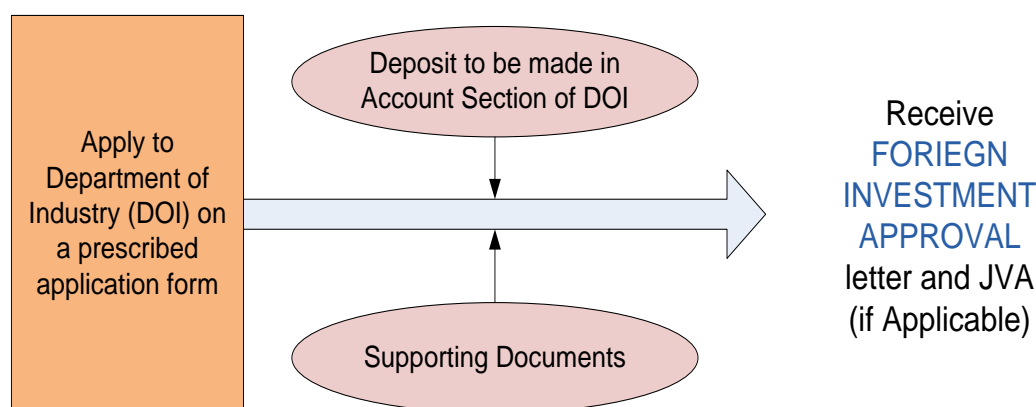


Typical debt securities that can be issued by companies are called debentures or bonds. Technically speaking, a debenture is an unsecured corporate debt whereas a bond is secured by a mortgage on the corporate property however; in common parlance the word bond is indiscriminately used and it often refers to both secured and unsecured debt. Debenture is an instrument of debt executed by a company acknowledging its obligation to pay interest on the debt at a fixed rate at regular intervals. Debentures do not carry any voting rights and are generally secured against property. Additionally, debentures can be redeemed or converted into equity or a combination of both.

While investing in Nepal, either of the above mentioned instruments or combination of the instruments could be used. The details of such instruments are provided below:

2.8.1. EQUITY SHARES

Foreign investors can invest in sectors allowed by the government and up to the limits permitted. Equity shares can be made through investment in new industry or existing industry through share transfer.



A) FOREIGN EQUITY INVESTMENT IN A NEW INDUSTRY

Foreign investor/s desiring to invest in Nepal whether as a wholly foreign owned enterprises or in a joint venture with Nepalese/foreign promoters are required to apply to the DoI on a prescribed application form¹², along with the documents mentioned in .

After the approval of foreign investment, up to a maximum amount (depending upon the envisaged fixed asset amount) NRs. 20,000.00 must be deposited in the Account Section of the DoI. The deposited amount shall be refunded (with interest) to the promoters once the project comes into operation. Once the stated amount is deposited, the promoters shall receive the foreign investment approval letter and certified JVA, if applicable.

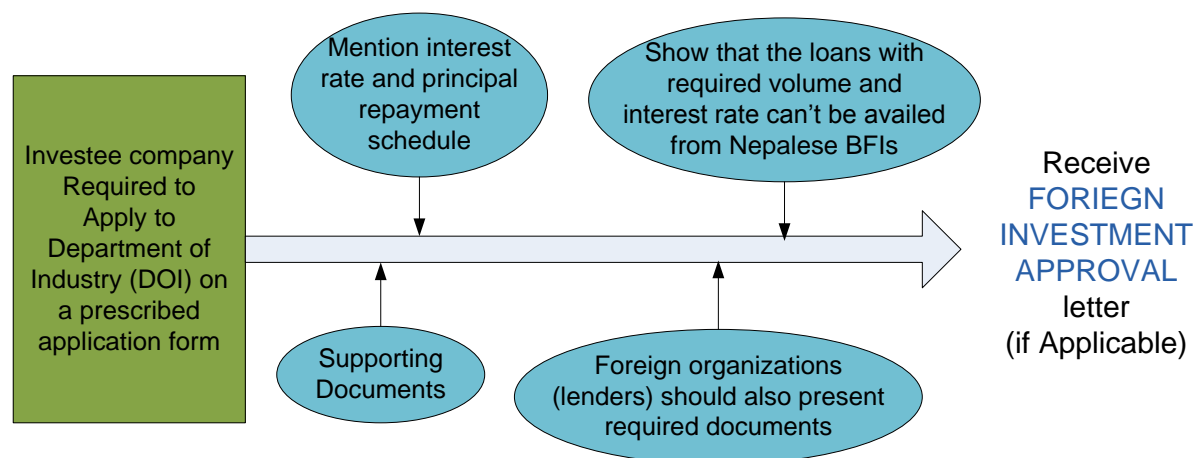
B) FOREIGN INVESTMENT IN AN EXISTING INDUSTRY BY SHARE TRANSFER:

Share transfer can be done in two ways, that is, by transferring the shares of existing shareholder or by issuing new shares to a foreign partner, either from the reserved shares or by increasing the issued capital of the company. The documents required for approval from DoI are presented in Annex 8.

2.8.2. LOANS

¹² Prescribed application form, suggested contents of the project report, JVA, and FCC has been provided in "Procedural Manual for Foreign Investment in Nepal, 2005" published by Department of Industries, Nepal Government.

Foreign investors are allowed to avail loan or loan facilities to individuals or companies in the form of foreign investment.



If an existing Nepalese company is willing to avail the loan or loan facilities from a foreign lending agency or individual, the company is required to apply to the DoI on a prescribed application along with the documents mentioned in Annex 9.

To obtain loans from foreign investors/institutions, Nepalese companies have to show that the loans with required volume and the interest cannot be availed from Nepalese BFIs. These companies should try to avail these loans from foreign BFIs. In case, this isn't possible, it can avail loans from foreign companies/organizations.

- These foreign organizations/companies (lenders) should present
 - Audited reports
 - Source of loan
 - Time schedule of repayment of loan
- For international and regional organizations that have members as international financial organizations like IFC, ADB, World Bank, can give loans to private sector as per NRBs decision
- Maximum loan interest at **One year LIBOR + 5.5%**

2.8.3. PREFERENCE SHARES

The Companies Act, 2063, Section 65 allows companies to issue preference shares in pursuant to the Act, the AoA and MoA of the company. While such preference shares are issued, following matters are needs to be disclosed:

- i) Preference of dividend against ordinary shares
- ii) Percentage of dividend to be received
- iii) Cumulative or non-cumulative dividends
- iv) Preference of paying amount in the event of liquidation of company
- v) Issues related to voting rights and excersiable proportion of such rights
- vi) Convertible or not (if convertible, conversion ratio, price, period)
- vii) Redeemable after certain period or not
- viii) Premium at the time of redemption

Thus, preference shares can be *cumulative* or *non-cumulative*. If preferred dividends are cumulative and are not paid in a particular year, they will be carried forward; however, preferred stockholders do not receive interest on the cumulative dividends. Moreover, such preference shares can be *redeemable* or *irredeemable*. The law requires the company to establish a capital redemption reserve account and a sum equal to the amount of shares redeemed shall be transferred to that account out of profits which would otherwise have been available for the dividend.

With regards, to convertibility of preference shares, The Companies Act, 2063 allows companies to issue convertible preference shares; however, the act is silent whether such conversion can be *compulsory* or *optional*. Hence, the issue of compulsory or optionally convertible can be entertained through contractual agreements. There is market precedence related to issues of optionally convertible preference shares issued by one of the leading public company in Nepal. Likewise, Everest Bank Limited has issued 7% irredeemable convertible preference shares that are compulsorily converted into preference shares (at certain time frame and in certain tranches).¹³

2.8.4. DEBENTURES

Onshore PE Funds organized as Public Limited Company can issue debentures for the general public, however, issuing of Debenture is not allowed unless issued capital is fully paid up and approval to commence business is obtained.¹⁴ Although the law does not impose any specific restrictions to private company to issue debentures, virtual restrictions do apply to restrict private companies from issuing debentures. The Issuer of debenture is required to fulfill certain procedural formalities before issuing debentures. The general procedure to issue debentures is:

¹³ The preference share is converted in to Ordinary Shares @ 20% on each 3rd year (in 3rd, 6th, 9th, 12th and 15th year) accordingly all the Preference Share will be converted in to ordinary Share in 15 years

¹⁴ Section 34 of the Companies Act, 2006

- i) Provision of debenture trustee¹⁵
- ii) Agreement between trustee and company in matters related to creditor and borrower
- iii) Conversion of debentures in MoA or AoA and prospectus

The issue whether the foreign investment is permissible in the debentures issued by Nepali Company is not clear. NRB has not published anything regarding the foreign investment on debentures of Nepalese Companies and has only provided the documentary requirements for obtaining exchange control approvals for loan and equity investment till the date. Although the NRB has not provided anything in obtaining investment approval to invest in debentures of Nepalese Company, NRB may allow the foreign investment in non-convertible debentures of Nepalese Companies as loan investment. Offshore PE Fund may be allowed to invest in dividend of Nepalese Companies as loan if it applies to NRB for the same. In Nepal, issuance of convertible debenture has not been practiced and almost all of the debentures issued till date are non-convertibles. Shreeram Sugar Mills is the only company in Nepal that has issued convertible debenture till date.

2.8.5. SHAREHOLDERS' LOAN

Shareholders' Loan is a very common mode of making investment in targets for both Onshore PE Funds and Offshore PE Funds. However, in the context of Nepal, there are certain caveats which concern the permissibility of loan investment by Onshore PE Funds. Section 47 of the BAFIA has identified issuance of loan as "Banking Transaction" and the NRB may take making loan investment as an act of issuing of loan which is reserved only for licensed Bank and Financial Institutions.

Offshore Funds may make loan investment in Nepalese targets and undertakings subject to certain restrictions imposed by NRB. Pursuant to the notifications issued by NRB dated January 22, 2013 read together with circular dated May 06, 2013 and circular dated September 11, 2013, Nepalese entities can borrow loans from foreign entities only when –

(a) the loan cannot be obtained from domestic banks and financial institutions, and (b) the interest charged by the foreign lender is lower than the prevailing interest rate in Nepal.

2.8.6. OTHER HYBRID INSTRUMENTS (SUCH AS INCOME PARTICIPATION CERTIFICATE)

Participation in the targets portfolios or undertaking by way of Income Participation Certificate, Asset Backed Securities, Mortgaged Back Securities, etc. are not much practiced in Nepal. Nepal does not have specific law to deal and regulate the Hybrid Instruments.

Foreign Investments in India, Sri Lanka and Bangladesh:

¹⁵ The Companies Act, 2063 defines "Debenture Trustee" as a body corporate undertaking the responsibility for the protection of interests of debenture-holders at the time of issuance of debentures by a company. Such Trustee has to be licensed by the Securities Board.

	INDIA	SRI LANKA	BANGLADESH
ENTRY ROUTE	<i>Automatic route</i> for investment in certain sectors with blanket approval	Foreign investors invest through <i>Securities Investment Account</i>	For businesses set up in export processing zone, get registered with Bangladesh Export Processing Zones Authority (BEPZA)
	<i>Government route</i> (obtain prior approval from concerned government bodies) for sectors and investments requiring special permission	Resident companies to obtain approval from the ECD (<i>Exchange Control Department</i>) to issue shares to foreign investors	For investments less than USD 2 million, register with Bangladesh Small and Cottage Industries Corporation (BSCIC)
			Else, register with BOI (Board of Investment)
BODY OVERSEEING SECTORS AND FORMS OF FOREIGN INVESTMENT	Department of Industrial Policy and Promotion (DIPP)	Board of Investment (BOI)	Investment Board promotes industrial investment while Bangladesh Small and Cottage Industries oversees smaller investments
FOREIGN EXCHANGE GOVERNED BY	Foreign Exchange Management Act, 1999 (FEMA) by Reserve Bank of India	Exchange Control Department	Foreign Exchange Regulations Act, 1947
OFFSHORE FUNDS	Can make foreign investments in the country in sectors that open for foreign investment within sectoral caps fixed by RBI.	Can make foreign investments in the country. Lending to Sri Lankan companies not allowed by offshore companies via ECB Scheme	Doesn't discriminate between offshore and onshore foreign investors while defining foreign capital and foreign private investment.
LIMITS ON INVESTMENTS BY FII	Single FII cannot invest more than 10% of equity capital or 10% of paid-up value of each series of convertible debentures issued by Indian company	Up to 100% of the issued capital of any Sri Lankan company (except in some prohibited sectors)	100 percent foreign equity is allowed in Bangladeshi companies

MINIMUM INVESTMENT FUND SIZE	Corpus of at least twenty crores	US\$ 250,000 for general sectors. For trading activities, this is far higher.	-
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2.9. REVIEW OF ENTRY OF PRIVATE EQUITY IN INDIA

Until early 2000s, PE Funds focused on IT companies. After the dot-com burst, these funds looked for diversification into other high potential sectors like manufacturing, infrastructure, e-commerce, pharmaceuticals and biotechnology. After 2008-09, PE funds gave priority to investments in traditional economy. Since 2011, PE funds have been more interested in PIPE (private investment in public equity) deals.

2.9.1. ENTRY ROUTES

Foreign investors can bring investments in the country via *Automatic Route* or *Government Route*. FDI in most sectors is now under what is known as the automatic route followed by certain post-facto filings with the RBI. Under government route, the foreign investor must obtain prior approval from concerned government authority, i.e. Foreign Investment Promotion Board (FIPB), Department of Economic Affairs (DEA), Ministry of Finance or Department of Industrial Policy & Promotion, for the investment.

Under automatic route, there is a blanket approval for the investment in certain sectors. For sectors and investments requiring special permissions, government route is prescribed. Under automatic route, a foreign investor would be able to invest in a sector in India without any prior governmental or regulatory approval, such as hotel and tourism.

2.9.2. REGULATORY FRAMEWORK

FDI policy formulated by Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India (GoI) discusses the allowed sectors and form of foreign investment into Indian businesses. Apart from this, sector-specific policies are issued by concerned ministries.

Foreign Exchange Management Act, 1999 (FEMA) by Reserve Bank of India (RBI) regulates foreign investment in India.

The issuance of shares and dealings in shares are governed by the Foreign Exchange Management (Transfer or Issue of security by a person resident outside India) Regulations, 2000 (the “**FI Regulations**”). *Sub-regulation 5 of the FI Regulations* (**Error! Reference source not found.**) lays down the conditions subject to which foreign investors would be permitted to invest into Indian securities.

The RBI has also issued Master Circular No. 15/2012-13 on July 2, 2012 (the “**RBI Master Circular**”) consolidating its rules governing foreign investment in India.

2.9.3. OFFSHORE FUNDS

A private equity investor may invest in India either directly through an offshore entity, or through an Indian subsidiary, using FDI Scheme. A foreign investor could also seek registration of their Category-I Alternative Investment Fund with SEBI to enjoy additional benefits and incentives available to Venture Capital Funds and Foreign Venture Capital Funds. Some notable incentives are SEBI registered VCFs can enjoy tax through status for taxation purpose and be exempt from the taxation. This would typically be done through a wholly-owned subsidiary of an offshore entity. But Overseas Corporate Body (i.e. registered outside India, with more than 60% of shares held by NRIs or by trust which has no less than 60% of shares by NRIs) are derecognized as a class of investors as of September 16, 2003.

2.9.4. ENTRY PROCESS

- PE approaches potential company
- Basic document, such as MoU, letter of intent or term sheet executed between the parties
- PE conducts legal and financial due diligence. Often followed by business due diligence and background check on promoters
- Negotiate investment documents, such as share subscription agreement, share purchase agreement and shareholder's agreement
- Investment made

2.9.5. LIMITS ON INVESTMENTS BY FOREIGN INSTITUTIONAL INVESTORS (FII)

A single FII is permitted to invest not more than 10% of the equity capital of an Indian company or 10% of the paid-up value of each series of convertible debentures issued by the Indian company. The total holdings of all FIIs put together should not exceed 24% of the paid-up equity capital or paid up value of each series of convertible debentures. However, this limit may be increased by the Indian company, up to the sectoral cap as applicable, by a resolution of the board followed by a special resolution of the shareholders, to that effect.

Private Equity Funds cannot invest more than twenty five percent of the corpus in one Investee Company.

Further, the investment should not be in a company which is engaged in the activity of manufacture of items listed in *Annexure A to Schedule I of the FI Regulations*.¹⁶ Also, the investment should not be in a company that requires an industrial license under Industrial Development (Regulation) Act, 1951 or under the locational policy notified by GoI under Industrial Policy of 1991.

2.9.6. PRICING METHODOLOGY

¹⁶ <http://www.welcome-nri.com/info/project/FIIregulationstext.htm#AnnexureA>

The price at which foreign investment is made or divested is required to be in accordance with the pricing guidelines specified under the FI Regulations. For subscription to shares of an unlisted company, the minimum price to be paid by the non-resident investor is linked to the valuation of the company, determined as per the discounted cash flow method of valuation (“**DCF Value**”).

In case of transfer of shares of a listed company (where the shares are being transferred by a resident to a non-resident), then the minimum price shall be as prescribed under the applicable Securities and Exchange Board of India (“**SEBI**”) Regulations such as the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (“**ICDR Regulations**”), SEBI takeover code, etc.

2.9.7. MODALITY OF PE FUND AS PER AIF ACT

As per the *AIF Act*, (**Error! Reference source not found.**) Private Equity Funds fall in Category 2 AIFs and can invest in *equity or equity linked instruments or partnership interests of investee companies*. The Alternative Investment Funds willing to work as Venture Capital Funds by investing their corpus primarily in unlisted securities of start-ups, emerging or early stage venture capital undertakings involved in making of new products, and delivering new services and technologies, enjoy tax and other benefits and are required to be registered as Category 1 AIFs. These funds should be close ended and the tenure of fund or scheme should be determined at the time of application. Minimum permissible tenure of these funds/schemes is three years. Each scheme of this type of fund should have corpus of at least twenty crore rupees.

PE Funds are mandated to invest *primarily* in unlisted securities or in units of other Alternative Investment Funds as may be specified in the placement memorandum.

2.9.8. PERMITTED INSTRUMENTS FOR PRIVATE EQUITY FUNDS UNDER THE FDI SCHEME

	Governing Scheme	Characteristics	Interest/Returns	Lock-In
EQUITY SHARES	Under FDI Scheme	Option to issue shares with differential voting rights, preferential dividends, or structured as liquidation preference	-	1-year in general. But, this is subject to sectoral regulations.
CCPS	Under FDI Scheme	Compulsorily and mandatorily convertible preference shares are to be issued to foreign investors	Cannot be in excess of 300 basis points over the Prime Lending Rate (“ PLR ”) of the State Bank of India	
CCDS	Under FDI Scheme	Fully and mandatorily convertible debentures are to be	FDI Scheme is silent on this	

issued to foreign
investors

Under the Indian law, foreign investors may only subscribe to equity or equity-linked instruments under the FDI route. Under this, investments in equity and compulsorily convertible preference/debentures are allowed. After December 30, 2013, the equity and CCPS instruments can have optionality clause, which will oblige the buy-back of securities from the investor by the investee companies at the price prevailing/value determined at the time of exercise of the optionality so as to enable the investor to exit without any assured return.

The permitted instruments can be categorized as:

A. Equity Shares

The investor may wish to have differential voting rights, i.e. voting rights that are disproportionate to their economic interests.

The investor may wish to receive a periodic return on their investment (in the form of preferential dividend or interest).

The investor may wish to receive a preferential return on the investment at the time of exit (structured as a liquidation preference).

B. Compulsorily Convertible Preference Shares ("CCPS")

Under the FDI Scheme, only preference shares which are fully and mandatorily convertible into equity shares are eligible to be issued to foreign investors. The RBI has prescribed that the rate of dividend payable on convertible preference shares issued to non-resident parties cannot be in excess of 300 basis points over the Prime Lending Rate ("PLR") of the State Bank of India prevailing on the date of the board meeting approving such issuance.

C. Compulsorily Convertible Debenture Shares ("CCDS")

Under the FDI Scheme only debentures which are fully and mandatorily convertible into equity shares are eligible to be issued to foreign investors. The debenture holder is entitled to receive interest from the company till the maturity date of the instrument, after which the debentures would be converted into equity shares.

As far as the rate of interest on the debentures issued to non-residents is concerned, the FDI Scheme is silent. Drawing similarity with dividend on preference shares as discussed above, maximum permissible rate of interest on debentures for FIIs would be 300 basic points over the PLR of the State Bank of India.

2.9.9. PERMITTED INSTRUMENTS FOR FOREIGN INVESTORS UNDER ECB SCHEME

	Governing Scheme	Characteristics	All-in-cost Ceilings over 6 month LIBOR	Minimum Average Maturity
OCPS	Under ECB Scheme	Up to USD 20 million	350 basis points	3 years
NCPS				
OCDS				
NCDS		Above USD 20 million to USD 750 million	500 basis points	5 years
Shareholder Loans				

2.9.10. CONVERSION PERIOD

For normal issuance, the time-period of conversion of convertible securities is 60 months (i.e. 5 years). For preferential allotment, the time-period of conversion of convertible securities is 18 month.

2.9.11. LOCK-IN

Under the ICDR Regulations, the entire pre-issue share capital (other than certain promoter contributions which are locked in for a longer period) of a company conducting an *IPO* is *locked for a period of one-year from the date of allotment in the public issue*. But, this is subject to sectoral regulations. *E.g. for defence and construction development sector investment, the lock-in period of three years has been prescribed.*

For preferential allotment or private placements by a listed company, there is no lock-in on such allotted securities (as long as they are traded on the stock exchange).

2.9.12. GAIN FROM SALE OF CCDS

Gain from sale of CCDs will be taxed like on same rate applicable on interest payments.

2.9.13. PERMITTED INSTRUMENTS UNDER ECB

Optionally convertible or non-convertible preference shares or debentures, or shareholder loans are permitted as investment instruments for foreign investors in India in accordance with the guidelines applicable for External Commercial Borrowings (ECBs).

However, as PE Funds fall under Category II of AIF – governed by FDI Scheme, it may be understood that these funds cannot be invested via ECBs. However, non-resident lenders can lend to Indian companies via ECBs.

2.9.14. EXTERNAL COMMERCIAL BORROWINGS (ECB), (INDIA, 2012)

- a. The maximum amount of ECB which can be raised by a corporate other than those in the hotel, hospital and software sectors is USD 750 million or its equivalent during a financial year.
- b. Corporate in the services sector viz. hotels, hospitals and software sector are allowed to avail of ECB up to USD 200 million or its equivalent in a financial year for meeting foreign currency and/ or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land.
- c. NGOs engaged in micro finance activities and Micro Finance Institutions (MFIs) can raise ECB up to USD 10 million or its equivalent during a financial year. Designated AD bank has to ensure that at the time of drawdown the forex exposure of the borrower is fully hedged.
- d. SIDBI can avail of ECB to the extent of 50 per cent of their owned funds including the outstanding ECB, subject to a ceiling of USD 500 million per financial year.
- e. ECB up to USD 20 million or its equivalent in a financial year with minimum average maturity of three years.
- f. ECB above USD 20 million or equivalent and up to USD 750 million or its equivalent with a minimum average maturity of five years.
- g. ECB up to USD 20 million or equivalent can have call/put option provided the minimum average maturity of three years is complied with before exercising call/put option.
- h. All eligible borrowers can avail of ECBs designated in INR from ‘foreign equity holders’ as per the extant ECB guidelines.
- i. NGOs engaged in micro finance activities can avail of ECBs designated in INR, from overseas organizations and individuals as per the extant guidelines.

All-in-cost ceilings:

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in-cost. The all-in-cost ceilings for ECB are reviewed from time to time. The following ceilings are applicable upto March 31, 2013 and subject to review thereafter:

Average Maturity Period	All-in-cost Ceilings over 6 month LIBOR*
Three years and up to five years	350 basis points
More than five years	500 basis points

* for the respective currency of borrowing or applicable benchmark

In the case of fixed rate loans, the swap cost plus margin should be the equivalent of the floating rate plus the applicable margin.

2.10 REVIEW OF ENTRY OF PRIVATE EQUITY IN SRI LANKA

The private sector has major investment in finance, exports, tea, apparel, IT, and tourism. Investments with an export dimension have the most potential with rapid infrastructure development and free trade agreements with India and Pakistan.

But, multinational and foreign investors complain that special preference is given to large local operators as the government procurement and project approval decisions favor large local operators. (State, 2013)

2.10.1. REGULATORY FRAMEWORK

The Board of Investment of Sri Lanka (the "**BoI**"), an autonomous statutory agency, is entrusted to regulate the foreign investment and grant foreign investment approvals. BoI has been promoting the following sectors as priority sectors for FDI: tourism and leisure; infrastructure; knowledge services; utilities; apparel; export, manufacturing; export services; agriculture; and education. Specialized divisions representing these sectors are tasked with providing services to foreign investors through the entire investment process.

The principal law governing foreign investment in Sri Lanka is the Board of Investment Act, 1978 (Amended 2012) (the "**BOI Act**"). The BOI Act provides for two different types of investment approvals:

- Foreign Investment Approval under **Section 16** of the **BOI Act**, where the projects receiving foreign investment would not be provided any type of fiscal concessions.
- Foreign Investment Approval under **Section 17** of the **BOI Act** for those projects where the projects receiving foreign investments normally will enjoy fiscal incentives and fewer exchange control restrictions.

The Strategic Development Project **Act of 2008** (SDPA) *provides* generous tax incentives for large projects that the Cabinet identifies as Strategic Development Projects. Other laws affecting foreign investment are the Securities and Exchange Commission Act of 1987 as amended in 1991 and 2003, the Takeovers and Mergers Code of 1995 (revised in 2003), and the Companies Act of 2007. (State, 2013)

2.10.2. OFFSHORE VEHICLES

In Sri Lanka, a Resident Company can issue its Shares to Non-Resident Companies without having to take any prior approvals from Exchange Control Department¹⁷ subject to certain restrictions and limitations.¹⁸

In addition to this, nine (9) different types resident companies¹⁹ in Sri Lanka which are classified as specified business entities under Sri Lanka Accounting and Auditing Standards Act, 1995 can issue and transfer both convertible and non-convertible, redeemable and non-redeemable debentures denominated in Sri Lankan Rupees to foreign institutional investors, corporate bodies incorporated outside Sri Lanka.

However, offshore companies are not permitted to lend to Sri Lankan companies on ECB basis.

2.10.3. ENTRY PROCESS

Foreign Investors can make investment in resident companies through SIA (scheme of account titled *Securities Investment Account*) as USD. One Million (USD 1,000,000) in trading sector and USD. Two Hundred When the foreign investors don't make investment via SIA, the resident company should obtain approval from the ECD As a matter of present, MCR for foreign investment has fixed Fifty Thousand (USD 250,000) for other sectors.

¹⁷ In Sri Lanka, Exchange Control Department of Sri Lanka is entrusted to administer Exchange Control Regime.

¹⁸ Gazette Notification No.1232/14 dated 19/04/2002 and 1248/19 dated 08/08/2002 issued by Exchange Control Department of Sri Lanka.

¹⁹ The nine different types of resident companies having specified business entities are : licensed Banks, licensed Insurance Companies, company carrying leasing business, companies carrying factoring business, companies licensed to operate unit trust, companies licensed to operate as stock brokers or stock dealers, companies licensed to operate stock exchanges, companies whose shares are listed in licensed stock exchanges, and other companies whose annual turnover turn over exceeds LKR 500 Million. (1 USD = 130.31 LKR)

2.10.4. SECTORS OPENED FOR FOREIGN INVESTMENT

Foreign investors can purchase up to 100% of equity in Sri Lankan companies in numerous permitted sectors however there are sectoral caps in a few sectors.

The government allows 100% foreign investment in almost all of the commercial, trading, or industrial activities save for few sectors which are either prohibited or capped with foreign investment limit.

2.10.5. SHARE TRANSACTION AND PRIVATE PLACEMENTS

i) Issue and Transfer of Shares of Companies to Non-residents:

Sri Lankan law requires that every transaction (wire transfer, remittance of dividends, transfer of sales proceeds of securities) in connection with the issue and transfer of Shares to non-residents to be done through Security Investment Account (SIA) opened in Commercial Banks.

ii) Private Placements in listed companies (for trustees):

Foreign Investors can acquire the shares in Sri Lankan Companies by way of Private Placement. However, the acquisition of shares by way of private placement should be within a limit of fifteen (15) percent of the total shares that are issued.

2.10.6. PERMITTED INSTRUMENTS FOR FOREIGN INVESTORS

	Characteristics	Maximum Limit	Interest	Conversion Period
EQUITY SHARES	Payment to be made out of SIA	Maximum of 15% of shares issued via private placements	-	-
BONDS	Permitted to purchase, sell or transfer Treasury bonds with any maturity period	Up to 10 % of the total outstanding Treasury bonds at any given time	-	-
DEBENTURES	Purchase <i>convertible</i> or	Up to 100% of the	Shall not exceed the <i>five</i>	Period of redemption or

	<i>non-convertible, redeemable or non-redeemable debentures</i> denominated in Sri Lankan Rupees	listed debentures	<i>year secondary market Treasury bond rate plus 200 basis points</i>	conversion to ordinary shares shall not be less than five years.
PREFERENCE SHARES	Tenure not less than 3 years and redemption not before one year of issue		-	Conversion may be effected at anytime
LENDING MONEY TO SRI LANKAN COMPANIES	<i>Offshore companies not allowed</i> to lend to Sri Lankan companies via ECBS	Allowed to lend USD 30 million or its equivalent value in any other foreign currency under the ECBS to a company	-	-

Apart from the equity shares in the companies, foreign investors can also invest in the following securities:

a) Bonds:

Foreign investors can purchase up to 10 % of the total outstanding Treasury bonds at any given time. FIs are permitted to purchase, sell or transfer Treasury bonds with any maturity period.²⁰

²⁰ www.cbsl.gov.lk/pics_n_docs/07_af_2pdm/_docs/.../invguide1.doc , p. 2 (accessed on June 25, 2014)

b) Debentures:

Permission has been granted for the issue and transfer of ***convertible or non-convertible, redeemable or non-redeemable debentures*** denominated in Sri Lankan Rupees in a company subject to following conditions:

- All debentures issued shall be listed in the Colombo Stock Exchange, while such issue may be made either by private placement or initial public offer.
- The period of redemption or conversion to ordinary shares, of the debentures issued shall not be less than five years and such conversion should be subject to the exclusions and limitations stipulated in the Government Gazette Notification No. 1232/14 of 19/04/2002.
- The debentures issued shall have a current credit rating from a local rating agency or international rating agency acceptable to the Securities and Exchange Commission of Sri Lanka.
- The rate of interest on the debentures shall not exceed the ***five year secondary market Treasury bond rate published by the Central Bank of Sri Lanka plus 200 basis points*** at the date of issuance of the debentures.

Further foreign investors have permission to invest up to 100% of the listed debentures in the Colombo Stock Exchange. (Tiruchelvam Associates, 2011)

c) Preference shares:

- The tenure of a preference share should not be less than three years from the date of issue.
- Redemption of the shares shall not commence earlier than one year from the date of issue and shall be phased out proportionately throughout the balance period.
- If the shares so issued are convertible into ordinary shares, such conversion may be effected at anytime and shall comply with the exclusions and limitations specified in the Government Gazette extraordinary No. 1232/14 of 19.04.2002 as amended (Lanka C. B., 2013)

d) Lending Money to Sri Lankan Companies:

Lending money to Sri Lankan companies is regulated by the External Commercial Borrowing Scheme (ECBS). ***However, this permission shall not apply to a company limited by guarantee or an offshore company.***

A borrower may obtain USD 30 million or its equivalent value in any other foreign currency under the ECBS provided that the maximum amount of borrowing per company per each calendar year shall be USD 10 million or its equivalent value in any other foreign currency.

- Shares held by promoters and all other shareholders prior to an IPO is locked in for a period of 9 months from the date of listing of shares in Colombo Stock Exchange (CSE)
- For the shares allotted within a period of one year prior to the date of Initial Listing Application, lock-in period of 12 months from the date of listing on the CSE. (Lanka, 2012)

2.10.8. INCENTIVES OFFERED ON INVESTMENTS

i) Investment Incentives for Strategic Development Projects:

The Strategic Development Project Act of 2008 provides tax incentives for large projects that the Cabinet identifies as Strategic Development Projects (SDP). SDPs are defined as investments that are in the national interest, likely to bring economic and social benefits to the country and change the landscape of the country through the provision of goods and services, substantial inflow of foreign currency, generation of employment and income, and transfer of technology. Information regarding projects selected as SDPs and incentives is published in the official gazette and needs to be approved by the Cabinet and Parliament. The incentives become operational upon parliamentary approval. Projects are exempted from taxes for up to 25 years. The exempted taxes include corporate income tax, Value Added Tax, Economic Service Charge, Debit Tax, Customs Import and Export taxes, Port and Airport Tax, and the Nation Building Tax.

ii) Incentives for Other Projects:

The BOI provides the following incentive regime:

- *Small-Scale Enterprises:* A 4-year tax holiday for small-scale enterprises in agriculture, animal husbandry, fisheries, and creative work, including art work and information technology. Minimum investment of Rs 25 million (US\$219,000). A 5-year tax holiday for fishing, fish processing, and the production of agriculture seeds.
- *Medium-Scale Enterprises:* A 4 to 6-year tax holiday for medium-scale enterprises in manufacturing, agriculture, agro processing, animal husbandry, fisheries, fish processing, IT/BPO, health care, education, beauty care, cold rooms/storages, tourism, sports and fitness centers and creative work, including art work. Minimum investment of Rs 25 million to Rs 200 million (US\$192,000 to US\$1.5 million).
- *Large-Scale Enterprises:* A 6 to 12-year tax holiday for large-scale enterprises in agriculture or forestry; manufacturing or processing of non-traditional goods for exports; manufacturing of boats, pharmaceuticals, tires, tubes, motor spare parts, furniture, ceramics, glass ware or other mineral based products, rubber based products, cosmetic products, edible products, construction materials; services provided to a person or partnership outside Sri Lanka; tourism or tourism related projects; infrastructure projects including construction of commercial buildings and warehouses, internal waterways, related transport (passenger or freight), renewable energy, industrial estates or knowledge cities, urban housing or town

centers, sanitation or waste management systems, water services, hospitals and health care services; maintenance of maritime vessels/ aircrafts; sporting services; software development; light or heavy engineering industry; dairy development; education services. Minimum investment of Rs 300 million to over Rs 2.5 billion (US\$2.3 million to over US\$19.2 million).

- *Import Replacement Industries:* A 5-year tax holiday followed by a concessionary tax rate of 12% for strategic import replacement industries (i.e., cement, steel, pharmaceuticals, fabric, and milk powder). Minimum investment levels apply.

2.10.9. REVIEW OF ENTRY OF PRIVATE EQUITY IN BANGLADESH

Bangladesh has seen huge surge in foreign investments in private sector over the past decade. Most of the investments are aimed at manufacturing industry, primarily in the garment industry. Investors have also put significant investments in country's telecommunications and banking sector. (Statistics Department, 2009)

2.10.10. REGULATORY FRAMEWORK

Foreign Exchange Regulations Act, 1947 regulates the payments and dealings in foreign exchange and securities. The Foreign Private Investment Act, 1980 promotes and protects foreign private investments in Bangladesh.

The Investment Board promotes industrial investments and offers facilities and assistance necessary for the establishment of industries in the non-governmental sectors.

While the Securities and Exchange Commission regulates the public issue market, separate notification regarding private placements is present in Bangladesh.

2.10.11. OFFSHORE VEHICLES

The Foreign Private Investment Act, 1980 doesn't discriminate between offshore and onshore foreign investors while defining foreign capital²¹ and foreign private investment.²²

2.10.12. ENTRY PROCESS

All FDI needs to be registered. If the business is to be set up in an export processing zone (EPZ) or industrial estate, registration must take place with Bangladesh Export Processing Zones Authority (BEPZA) or Bangladesh Small and Cottage Industries Corporation (BSCIC – if investment doesn't exceed USD 2 million / Tk 100 million). If the business is to be set up elsewhere, it must register with the BOI.

A manufacturing firm employing ten or more workers must also register with the Chief Inspector of Factories and Establishments. Pre-registration clearance is required for investment in the following areas: ready-made garments, banks, insurance companies, and other financial institutions.

The Investment Board Act of 1989 outlines the process of making foreign investment in private sector in Bangladesh:

1) Registration:- All industries established in non-governmental sectors except industries under the control of the Bangladesh Export Processing Zones Authority, the Bangladesh Small and Cottage Industries Organization, textile industries set up on their own capital and industrial undertakings licensed by the Board shall be registered in the prescribed manner.

2) License: These industries shall make an application to the Board in the manner and form prescribed by the Board.

* the Government may from time to time, by notification in the official Gazette, on recommendation of the Board, exempt any industry or industrial undertaking from the application of this section.

3) Approval: Where on consideration of an application, an undertaking has been considered fit for approval, the Board shall, under the strict conditions of its consideration, approve the scheme and grant a

²¹ “**foreign capital**” means capital invested in Bangladesh in any industrial undertaking by a citizen of any foreign country or by a company incorporated outside Bangladesh, in the form of foreign exchange, imported machinery and equipment, or in such other form as the Government may approve for the purpose of such investment – Foreign Private Investment Act, 1980

²² “**foreign private investment**” means investment of foreign capital by a person who is not a citizen of Bangladesh or by a company incorporated outside Bangladesh, but does not include investment by a foreign Government or an agency of foreign Government – Foreign Private Investment Act, 1980

license to the applicant, and shall determine in such license the period within which to implement the scheme and to start production

2.10.13. INVESTMENTS SECTORS

Bangladesh allows foreign investment in all sectors of economies except the following four sectors:

- arms and ammunition and other defense equipment and machinery,
- forest plantation and mechanized extraction within the bounds of reserved forests,
- production of nuclear energy, and
- security printing and mining

2.10.14. LIMITS ON INVESTMENTS BY FII

For foreign direct investment, there is no limitation pertaining to foreign equity participation, i.e. 100 percent foreign equity is allowed. Non-resident institutional or individual investors can make portfolio investments in stock exchanges in Bangladesh.

2.10.15. GENERAL INCENTIVES

In addition to incentives for the private investor, foreign investors are also entitled to the following (Betelco):

- Tax exemption on capital gains from the transfer of shares by the investing company;
- Avoidance of double taxation in case of foreign investors on the basis of bilateral agreements
- No restriction in issuing work permits to foreign nationals in Bangladesh
- Facilities for repatriation of invested capital, profits and dividends
- Provision for transfer of shares held by foreign shareholders to the local shareholders/investor with the permission of the BOI and the Exchange Control Department of the Bangladesh Bank.

2.10.16. MODALITY OF PE FUND

Foreign institutional investors (FIIs) can simply open a non-resident investor's taka account with a bank, and then invest directly in listed securities and pre-IPOs. (FinanceAsia, 2012)

2.10.17. INVESTMENT INSTRUMENTS UNDER FDI

Under Foreign Direct Investment, foreign investors can invest up to 100% in the investee companies in Bangladesh.

	Characteristics	Lock-In Period	Interest	Repayment Period
EQUITY and DEBT	Can invest up to 100% in the investee companies in Bangladesh	3 years for directors and those who hold 5% or more shares. 1 year for others	-	-
FOREIGN LOANS	For customized loans, obtain approval from BOI	-	Should not exceed LIBOR+4%	Shouldn't be less than 7 years

a) *Equity and Debt:*

There is no general restriction on equity participation, acquisition of property or management control by a foreign firm. It is not clear on the instruments type and other features. But, Bangladesh asserts to be welcoming foreign investors in any form and type. Documents only talk of ownership of companies and not the method of ownership.

b) *Foreign Loans:*

Foreign loans falling within the following guidelines aren't required to obtain prior approval from BOI.

- The effective rate of interest should not exceed LIBOR+4% (effective interest is the sum of the stated annual rate of interest and the annualized fees such as commitment fee, syndication fee, front-end fee, project appraisal fee etc.).
- The down payment, if any, in case of suppliers' credit should not exceed 10% of the credit amount.
- The repayment period should not be less than 7 years.

* Foreign investors cannot buy national savings bonds. They also cannot sell their shares through public issues.

** Foreign investors can invest in listed securities. They can also invest in new private placements of the shares of industrial enterprises. There are no restrictions on the transfer of shares to other non-residents. (Commerce, 2000)

2.10.18. LOCK-IN PERIOD

The security (except debt security without conversion feature) including the equity security issued in part or in full against any convertible security by a listed company for which the consent is accorded under these Rules shall be subject to a lock-in of

- (a) 3 (three) years in case of directors and those who hold 5% (five percent) or more shares, and
- (b) 1 (one) year in case of others, from the date of issuance of such security, or from the date of issuance of consent, whichever is later

Provided that the time involved in between the issuance of convertible security and converted equity security shall be counted for the lock-in period:

Provided further that the said lock-in shall also be applicable in case of issuance of equity security against loan or debt security having no predetermined conversion feature if such equity security is not issued at a price equal to last 6 (six) months' weighted average market price at the stock exchange. (SEC, 2001)

CHAPTER THREE: OPERATIONAL ASPECTS OF THE PRIVATE EQUITY FUND

3.1. RIGHTS OF MINORITY SHAREHOLDERS

In most investment scenarios of PEFs, the investor is a minority shareholder in the company²³, except in case where the PEFs is set up under the bulk investment from high net worth individual and institutional investors. In venture capital funds or PEFs, the protection aspect of minority shareholder is the most vulnerable part as most of their contributions are invested in high risk projects or undertakings. Beside the minority investors do not have substantial degree of control in making investment decisions. In case of PEFs registered in Nepal (Onshore PEFs), Minority Shareholders can exercise the rights that are recognized as the right of Minority Shareholders under Companies Act, 2006. Apart from the limited protection afforded by the statute, minority shareholders investing in the PE Funds can also extend their rights through Shareholders' Agreement after negotiating with the existing Shareholders of the Company and the Company. For example, a minority shareholder through a Share Holder Agreement with the Venture Fund Company can exercise his right to be consulted through or his right to exercise the put option by negotiating the same on Shareholders Agreement. Companies Act, 2006 under Section 30(1) of Company Act, the Minority Shareholder of Company can elect to acquire shares of different class. Similarly, the Minority Shareholders can extend their rights through Agreement with other Shareholders of the Company.

The Shareholders' Agreement between Minority Shareholder and the Company is enforceable at the court of law, provided that the provisions in the Shareholders' Agreement are not inconsistent with the Articles/ Memorandum of Association of the Onshore Fund. As per court practice and precedents laid down by the Supreme Court of Nepal, the provision in Articles/ Memorandum of Association supersedes the provisions of the shareholders agreement.

As there is no special framework to deal with PEFs, minority shareholders should seek the remedy against the operations by majority shareholders or controlling shareholders under the regular minority protection provision of the Companies Act, 2006.

Certain redress is available under the Companies Act, 2006 to Minority Shareholders against the oppression and exploitation by Majority Shareholders. The redress available under the Companies Act is presented in the table below.

Nature of Oppression/	Authority to	Percentage (%) of	Redress Available
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²³ As a matter of general understanding, PEFs creates a dedicated pool of investible funds from large number of Investors and the such large number of minority investors do not have control in the day to day affairs and making of investment decision in PEFs.

Redress	receive Complaint/ hear grievances	shareholding required to file complaint.	
Unauthorized Act of Directors or Officials of the Company	To Appellate Court prescribed.	Not specified.	Injunction against the unauthorized act.
Act against the right and interest of the Shareholders	To Appellate Court prescribed.	Not specifies/ any single shareholder. <i>The shareholder has onus to prove 'act against the interest of shareholder',</i>	<ul style="list-style-type: none"> • Injunction Order • Order to file civil suit against the person responsible • Cancellation of registration of Company • Order to buy the shares of the victimized shareholders • Order responsible officials or directors to compensate the loss.
File suit against the any director, officials or third party to enforce the interest of the company.	To the Court of Appeal as prescribed in the Gazette.	Five Percent (%)	
Oppression of Minority Shareholders and Mismanagement of Company.	Office of the Company Registrar (OCR).	Five Percent (%)	<p>The OCR will direct the investigators to produce an investigative report.</p> <p>The OCR may order the needful on the basis of such investigation report.</p>
Requisition of Extraordinary General Meeting (EGM)	Office of the Company Registrar.	Shareholder holding 10% of total paid up shares or 25% of the shareholders.	The OCR may, upon itself, call the EGM of the Company.
Invalidate the decision of General Assembly	Office of the Company	Any single shareholder can make complaint to OCR to invalidate the decision taken	The OCR can invalidate the decision of the General Assembly in the case of

of Private Company.	Registrar.	in General Assembly of Private Company in case he was not given opportunity to be present in General Meeting of the Private Company.	receiving proof that any Shareholder of the Private Company was not given the opportunity to be present in the General Assembly.
		The complaint should be made within 3 months of the General Meeting.	

3.2. QUALIFICATION FOR BOARD OF DIRECTORS

Companies Act, 2063 of Nepal does not list out the qualifications required to be a director of the company, be it private or public except for the independent directors of a public company. However, Directors of the public company are disqualified from the post on grounds like committing an offense resulting into moral turpitude, being insolvent, in case of mental instability. Independent directors (directors having no ownership interests in the company) should possess certain qualifications like 10 years' experience and expertise in fields of law, economics, management, accountancy, etc. and a person who does not have conflict of interest, etc.

There is no restriction to foreign shareholders or foreign institutional shareholders to appoint a non-Nepalese national as a nominee director. Relatively fewer degree of restriction in eligibility of directors caters a good working environment for operation of PE Funds.

3.3. REPRESENTATION OF PORTFOLIOS AND DIRECTORS' LIABILITIES

Representation in Portfolios is open for Venture Capital Funds under the existing Companies Act, 2006. A Private Equity Fund or Venture Capital Fund investing in the equity of domestic Venture Capital Undertakings (Portfolios) has the right to appoint an institutional director for Portfolio Company in proportion to their shares in the undertakings or portfolios. Minimum shareholding requirement is not applicable in the case of Institutional Director so appointed. Such Institutional Director may also appoint an Alternative Director to represent him/her in case he/she cannot be present in person at the meeting of Board of Directors of Venture Capital Undertakings or Portfolio Company.

The provision in the present FITTA²⁴ along with the Draft FITTA²⁵ guaranteeing/safeguarding the right of Business Visa to the Foreign Investors and their representatives provides a comfortable working situation to foreign institutional investors and investors.

However, the thing is not free from caveats. An important issue that may arise is related to the potential conflict of interest that may be faced by investor-appointed/ nominee directors. Statutorily, Directors owe a fiduciary towards the company – to act in the interest of the company. However, the institutional investor of PE Funds wishes that their appointee / nominee directors acts in the interest of the fund. This conflict results in nominee directors having to tread a thin line between the investors and the company. As a consequence, veto rights are often exercised directly by the investing entity rather than the nominee directors; the exercise of Veto may not be in the interest of the investee targets or undertakings sometimes.

Directors face numerous other risks in relation to the operation of the company and can even be held criminally liable in some circumstances. It is important therefore for the appointee/ nominee directors that they are sufficiently indemnified and that the company maintains an appropriate directors' and officers' liability insurance policy.

3.4. DELEGATION OF AUTHORITY

As per the law, the Board of Directors of a Company can delegate its managerial and decision making authority to any individual director or any other person. However, the law imposes certain restrictions on it.

Decisions making in relation to (a) demanding the payment of due amount of subscribed shares from shareholders, (b) issuing debentures (c) borrowing loans or credits by other ways than debentures (d) making investment from the fund of the company (e) providing loans is reserved for the meeting of Board

²⁴ Section 6(2) of the FITTA provides that the Foreign Investors, dependent family member of foreign investors or their authorized representative will be granted Business Visa so long as they have foreign investment in Nepal.

²⁵ Section 8 of the Draft FITTA provides that the institutional shareholders, their dependent family member, their representative and their representative subject to the foreign investor fulfilling certain terms and conditions.

of Directors . Such restrictions, particularly, making investment and providing loans may not be compatible with investment practice in a PEFs investment regime.

Customarily, In every Private Equity Investment Regime, Investment Manager appointed on a contractual basis and registered with the regulatory bodies (for example, say, Security and Exchange Board may be regulatory in the context of Nepal) makes the decision to invest or make loan to the targets from the amount on fund.

Alternatively, it is not always possible for the directors of the PE Funds to be present in person every time the investment decisions needs to be made and customarily the Directors of the PE Funds are passive actors in the context of making of investing decisions. Companies Act, 2006 under Section 95 (7) has exempted the Bank and Financial Institutions to comply with the said restrictions, considering the practicality and business nature of Bank and Financial Institutions. So, in view of creating a comfortable working environment to PE Funds, while investing in targets, Company's Advisory Board may exercise its authority under Companies Act and relax such restriction (like it has been given to licensed Bank and Financial Institutions) by issuing clarification or otherwise.

3.5. BLACKLISTING

Nepal has a robust regime on Blacklisting of defaulter. Before the recent amendments in NRB's provision on Blacklisting of defaulter, the institutional shareholder and the nominee director having 15% or more equity stake in the defaulter company²⁶ were blacklisted at Credit Information Centre Limited.

The said provision creates a substantial degree of risk to both Offshore PEFs and Onshore PEFs. However, the recent amendment in the Blacklisting provision of NRBs has exempted (a) foreign investors investing in equity of defaulter after obtaining foreign investment approval (b) Foreign Diplomatic Mission (c) Donor Agency and (d) Development Partner enjoys immunity from blacklisting if the investee company to which they are investors defaults in loan repayment and debt service. However, this facility or exemption may not be available to Onshore Venture Capital Funds. VCFs has been customarily investing in risky projects or undertakings and default to service debt by high risk projects can be genuinely expected. Such blacklisting provisions may deter the PE Funds or VC Funds to invest in high risk undertakings and ultimately limiting the growth prospect of high risk but promising projects. Given the robust regime on Blacklisting, Offshore PEFs may be an desirable option than Onshore PEFs while making investment in high risks undertakings and high risk start up projects.

The said provisions posed an enormous degree of threat to Foreign Investor, until recently. However, as per the recent amendment in the Blacklisting provision of NRBs, foreign institutional investors, such as: (a) foreign equity partner who has come under approval route (b) Foreign Diplomatic Mission (c) Donor Agency and (d) Development Partner are exempted from blacklisting in the situations where there's investee in Nepal defaults to service debt to licensed Bank and Financial Institutions. However, this

²⁶ Here, Defaulter Company means the company defaulting in loan repayment and debt service to licensed institutions.

facility or exemption may not be available to the Onshore Venture Capital Funds. So, creating Offshore VCFs or PE funds can be a desirable option to prevent the blacklisting risk.

3.6. VISA AND WORK PERMIT

Under section 6 (2) of FITTA 1992, the foreign investor (with the exception of individual investor) investing in excess of USD 200,000 (Two Hundred Thousand US Dollar) per investment year and their dependent family members and the authorized representative of the foreign investor has the right to obtain 5- year Business Visa in Nepal, till the time such investments retains in Nepal.

3.7. DISPUTE SETTLEMENT

Section 7 of FITTA 1992 provides that the disputes between the foreign investor²⁷, domestic companies should be settled through mutual consultations in the presence of Department of Industry. In case the parties to the dispute remain unable to settle their dispute even after the mutual consultation, then the dispute shall be referred to an arbitration panel in Kathmandu and the governing law of arbitration will be the prevailing Arbitration Rules of the United Nations Commission on International Trade Law (UNICTRAL). In the event of dispute between foreign investors and domestic companies, matters such as nationality bias may put foreign investor in jeopardy.

Parties to the Investment (the foreign investor and investee) are free to choose the governing law of arbitration on their own only when the amount of investment under the Investment Agreement exceeds Rs. 500 Million. This threshold of Five Hundred Million, which determines the ability of the parties to choose the governing law on disputes, is not workable in the context of PE Funds investing in the Small and Medium Scaled Enterprise and Start-up undertakings.

3.8. FILING AND REPORTING REQUIREMENT

Onshore PEFs and also the targets or undertakings (entities/ undertakings receiving investment from Onshore PEFs and Offshore PEFs) are required to file copies of several of corporate documents, including, Annual Financial Statement, Board Resolutions, Minutes of Annual General Meetings, Minutes of EGMs etc to Office of Company Registrar. The failure to file and report the foregoing will make directors and other key officers of the onshore PEFs and the portfolios liable to pay fines under Section 81 of Companies Act, 2006.

The filing and reporting requirements are highly penalty driven and penalties get cumulated every year.

²⁷ For the purpose of PEFs, the term "foreign investor" should mean as offshore investor investing in Onshore PEFs or Offshore PEFs investing in Nepalese target ventures or undertakings.

3.9. INVESTMENT LIMIT

PEFs are typically a capital fund that have dedicated pool of investible funds and the main objective behind establishing/ setting up such fund is to make investment in the target portfolios. Although, PEFs or funds of similar nature has been given a legal recognition as an Investment company after the recent notification of May 18, 2011, there are some restrictions under the existing laws potentially impeding the functioning of the PEFs as an investment fund. As investment companies have not clearly been exempted from the restriction provided under Section 176 of the Companies Act, Section 176 may also interpreted that the onshore fund cannot make investments in or provide loan to the portfolio companies in excess of its-(a) 60% of the sum total of the paid up capital and free reserve, or (b) 100% of the free reserve whichever is higher. The said provision will not allow the PEFs to invest beyond 60% of its investible corpus.

CHAPTER FOUR: EXIT AND REPATRIATION

4. EXIT

Regulatory issues concerning the exit of the PE Funds are equally as important as the issues that concern the entry of the PE Fund. PE Funds usually have a limited lifespan of 8-10 years. Due to their limited and relatively short life span, the regulatory issues concerning the exit highly affect the implementation of their strategic interest.

This chapter will highlight the exit options available to the PE Fund vis-a-vis the existing regulatory constraints impeding the speedy and efficient exit of the PE Fund. The issues concerning the repatriation after the exit of the Offshore PE Fund from the targets have also been separately dealt hereunder.

PE Fund investing in the Nepalese targets has an option to exit from at least two different routes: (a) Public Route, and (b) Private Route. The exit mode which involves the selling of securities to general public is taken as public route and those which does not involve the selling of the securities to the public is taken as the Private Route in this report. Opting for the Public Route necessarily involves the process before the Nepal Stock Exchange whereas the Private Route does not necessarily involves the process before the Nepal Stock Exchange.

The PE Fund can exit from so-called Private Route by following ways-(a) recover the loan with interest post the maturity of loan period or earlier, (b) sell the security up to 50 number of shareholder, (c) buy back of the unlisted securities, (d) exercising put options, (e) capital reduction, (f) redemption of preferred shares, etc.

Similarly, the PE Fund can exit from so-called Public Route by following ways- (a) public sale of the securities through stock exchange, (b) redemption of listed preferred shares, (c) buyback of listed shares, (d) redemption of non-convertible debentures. Sale of security through Public Offerings, buyback/redemption of the listed securities, Repatriation of Dividend, repayment to the debentures and other equity linked instrument etc can be classified as exit under the Public Route.

The available exit routes and their classification are presented in the table below;

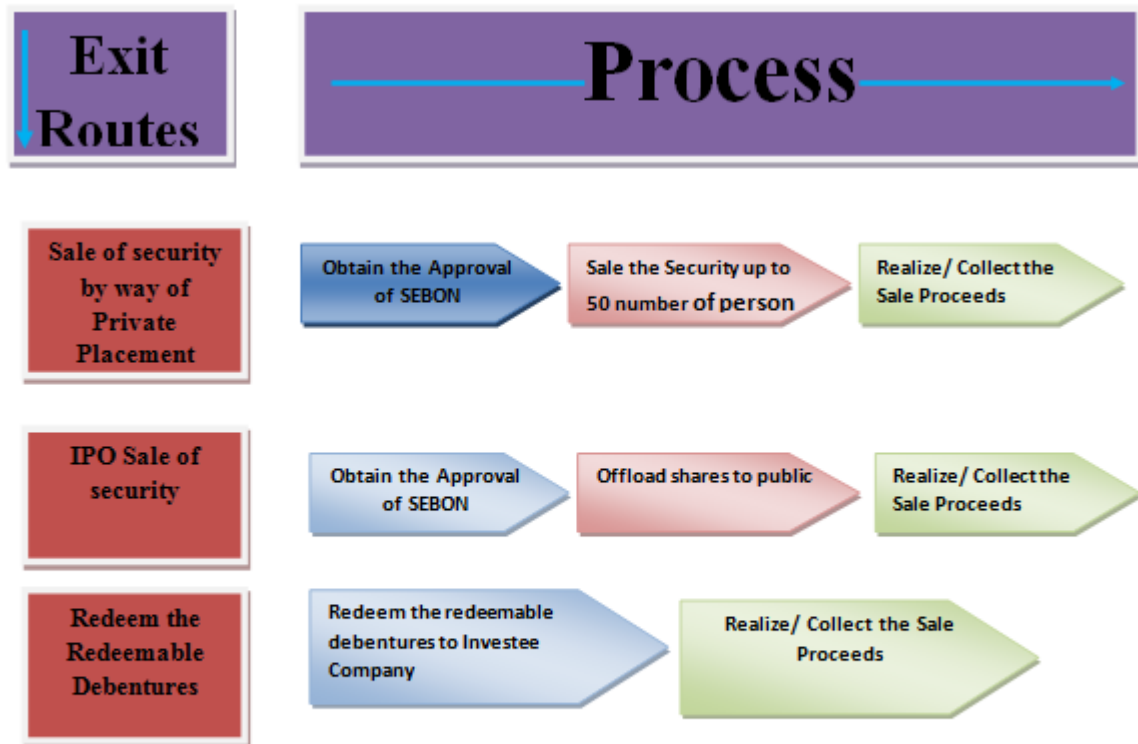


Fig: PE Fund exit through Public Route

Fig.1 Illustration of exit routes available to Offshore Funds

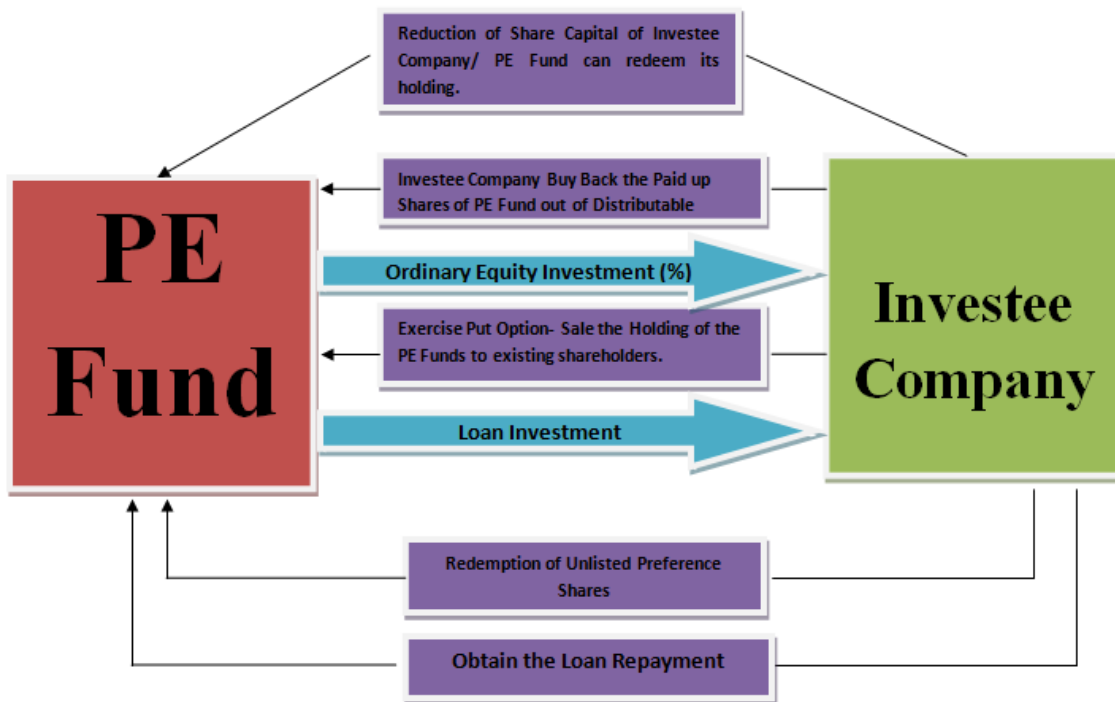


Fig: Exit of PE Fund through Private Route

4.1. EXITS THROUGH PRIVATE ROUTE

PE Fund can exit through the Target in Nepal by adopting private placement route. Compliance to regulatory requirements is relatively lesser while adopting private route than public route. The different types of private route s and the issues concerning thereof has been briefly discussed in the paragraphs below;

4.1.1. BUYBACK OF UNLISTED SHARES

Buy back is a scheme wherein the companies re-purchase their own shares from its shareholders. Buy back can be a very good exit strategy where the PE Investors could agree to exit via buy-back of shares at a mutually agreed internal rate of return.

Buy- back is generally prohibited under the Companies Act, 2006; however, it is allowed subject to the satisfaction of certain conditions. Following key conditions will need to be satisfied for the buy-back of shares: -(a) subscribed capital till the date of buyback to be fully paid (b) listing of the shares in securities board if the company is a public company, (c) buy back being consistent with the articles of association, (d) certainty that the ratio of the debt to sum total of paid up capital and general reserve fund [total debt: (paid up capital + free reserve)] will not exceed the ratio of two-to-one (2:1) after buyback transaction (f) amount to be used for buy-back will not exceed twenty(20) percent of sum total of free reserve and paid up capital, etc.

Pursuant to Section 61(2) of the Companies Act, the companies can fund the buyback of shares only out of the amount available in the company as a distributable profits.

Onshore PE Fund and Offshore PE Fund cannot exit from Investee Company that is operating in loss; for the obvious reason that the Company operating in loss will not have any distributable dividends.

The onerous condition on redemption makes it impossible for the PE Fund to exit through Investee Company by way of buyback operating in loss even if wish to sell its holding to the investee at a rate than in the time of acquisition or purchase, which results in trapping of capital inside the investee company. This will not allow the PE Fund to implement its strategic interest to exit within the predefined time period.

To overcome the possibility of fund trapping reasonable, amendment should be made in the Companies Act, particularly considering the case of investors like PE Funds, so as to allow the PE Fund to exit from the investee company which is operating in loss.

4.1.2. EXIT EXERCISING PUT OPTION

"Put Option" is an option available to the investor, wherein the investor has an option to sell the subscribed/ acquired shares at a mutually agreed price (*agreed price at the time of Share Subscription/ Acquisition Agreement*) after certain period from the date of the investment. The Put option has not been explicitly recognized under the provision of the Nepalese Companies Act, therefore, the arrangement for 'put option' is done through the Shareholder's Agreement or separate put option agreement.

In practice, approval from DOI and NRB are obtained by the investors to enter into the put option agreement in order to avoid any risks at the time of repatriating the sale proceeds.

The agreed rate of return will be normally higher than the value of the acquiesced/subscribed shares or will be in a premium rate. The requirement of valuation report might operate as an obstacle for the foreign investor to exit through the put option right in a situation where the agreed put option price is higher than the price derived from the valuation.

4.1.3. CAPITAL REDUCTION

The PE Fund can exit from the target by reducing the capital structure of the target equivalent to its holding there. Section 57(2)(a) of the Companies Act permits the companies to reduce its capital by refunding the paid up capital after taking requisite approval from the court. The capital reduction can be a very convenient way for exit; however, the requirement of the approval from the court and restriction on refunding the capital on premium rate may create some practical complexity.

Pursuant to Section 57 read with Section 58 of Companies Act, the companies are not allowed to reduce its capital by refunding the capital at a premium rate even if the assets of the companies has sufficiently increased and the assets and receivables of the companies exceeds the liabilities; while the valuation and subsequent price adjustment requirement are mandatory while the companies liabilities exceeds the assets and receivables. Amendment to Section 57 of the Companies Act appears to be necessary in order to allow the convenient exit of PE Fund from its investee company.

4.1.4. REDEMPTION OF THE SECURITIES

Both Onshore and Offshore PE Fund participating in the investee company by way of preferred equity can exit from the investee company by redeeming their preferred equity at a rate that was agreed during the time of subscription.

However, as per the provision of the Companies Act, the redemption of the preferred shares can be funded only out of the amount available as distributable profits or amount collected in the redemption account through fresh issue of securities. The said conditions restrict the PE Fund to exit from the investee company by redeeming their equity , where , investee company - (a) is operating in loss (b) does not have any sum left as distributable profits for other reason than loss, for instance, company undertaking ventures of longer gestation period but in stage of commercial operation and shows potential future return.

The PE Funds investing in the investee company undertaking the projects having relatively longer gestation period cannot redeem their redeemable equity within their life span. Restriction in funding the redemption from paid up capital or through debt should be lifted particularly in case of PE Funds.

4.1.5. LOAN REPAYMENT

The PE Fund participating in the investee company by way of loan or other related instrument can exit from the investee after securing the loan repayment upon the final maturity of loan period or earlier on the consent of the borrower. While Onshore PE Fund may not face serious issues while routing its exit through loan repayment, there are certain issues which concerns the ability of the Offshore Fund to secure its loan investment.

Pursuant to the NRB notification September 11, 2013, a borrower in Nepal cannot repay the foreign loan if -(a) it is blacklisted before Credit Information Centre Limited, or (b) any it has any payable debt to local banks and finance Company. The said provision puts the interest of the Offshore PE Fund to recover the foreign loan in a situation of absolute jeopardy. Apart from this the said conditions also overlooks the modern practice of loan investment through subordinated debt function and the consortium partnership of foreign lenders and local Banks and financial institutions.

The NRB's protective approach in treating the local banks and financial institutions is likely to deter the foreign lender including the Offshore PE Fund to make loan investment in ventures and undertakings of Nepalese Companies.

4.2. EXITS THROUGH PUBLIC ROUTE

The PE Fund can exit from the investee companies placing its securities in public for subscription. Public Placement is mandatory when the securities of the Investee Companies are listed in Stock Exchange and on Private Placement through circular method. The different types of exit route available under public placement along with the possible issues that PE fund may face have been discussed below;

4.2.1. INITIAL PUBLIC OFFERINGS ("IPOS")

Initial public offering (IPO) or stock market launch is a type of public offering where shares of stock in a company are sold to the general public, on a securities exchange, for the first time.

The private companies are not allowed to raise any money through public subscription. Only those companies which are registered as the public companies and satisfy certain qualification requirement under the Security Laws are eligible to raise money through public subscription and IPOs.

PE Funds or VC Funds who have participated in the undertakings organized/incorporated in the form of private companies by way of equity investment cannot exit directly through IPOs as Private Companies are not allowed to opt for IPOs under existing Nepalese Laws. However, PE Funds or VC Funds may exit from the investee through IPO after the investee converse itself into Public Limited Company.

A private company can process the conversion to the public company after -(a) obtaining authorization from the general meeting through a special resolution for conversion, and (b) fulfilling other requirements to be a public company; for e.g. Rs. 10 million paid up capital, minimum seven number of directors etc.

Apart from the issue like delays, the PE Funds will face numbers of issue while exiting from their investee through IPO route. The issues concerning the PE Funds exit from the investee will be briefly discussed hereunder. The procedures for IPO is presented in Annex-10 attached to this report.

4.2.1.1 RESTRICTION ON FIXING THE VALUE OF SHARES ON MARKET PRICE

- (a) Security Issue Regulation states that generally, security (share) must have a face value equal to 100 rupees.²⁸ In addition to this, Rule 24 of the Regulation states that shares must be issued at the face value, unless the conditions in the companies are fulfilled (the conditions in Companies Act are that the company should have made profits for three years and have a net worth exceeding its liabilities) and that the share premium does not exceed the net worth per share). The company also has to justify the methodology for calculating the share premium.
- (b) These provisions are simply inappropriate. The value of the shares will be based on a number of factors concerned with past performances and future prospects. Past performance is essentially a credible factor that can predict the future prospects of a company but it does not hold good to be reliable every time. For example, in the case of a long term infrastructure investment project or Research and Development project, there may be substantial initial borrowings and therefore minimum net worth and obviously no history of profit distribution, but goods prospect for future.
- (c) The fixed pricing norms undermine the rights of the investor to make their own assessment as to the existing and future value of the shares. The profit history of a company is surely of relevance to an investor but there is no justification for setting a requirement of three years of profit as a basis for allowing the issue of new shares at the market price (rather than face value). Investors should be permitted to make their assessment.
- (d) The restriction on fixing of price at the time of issue has serious impact on the PE Fund than other companies. PE Fund has to wait for more than three (3) years post the commercial operation date (and, sometime post the breakeven point) to exit from PE Fund securing profit. Selling shares at the premium rate is the only option available to the PE Fund which typically has a very short and limited lifespan. PE Funds will be force sell their security (share) at much lower price even if the true market price of a security is many times above the face value.

4.2.1.2. MINIMUM PROMOTER'S HOLDING

Security Issue Regulation under Rule 7(4) requires the promoters of the company to maintain a holding of at least fifty one (51) percent of the offering companies' equity post the IPO. This requirement that promoters should always have a majority shareholding does reduce, to some extent, the problem that the management of company may have interests that differ from those of shareholders. However, the provision operates to restrict the exit of PE Funds having majority stake in the investee through promoter's shares, by offloading all of their holdings in a single public offer. SEBON may relax the said

²⁸ Rule 20 of Security Issue Regulation, 2007 (2065)

requirements on post IPO holdings particularly in the case of PE Fund considering their relatively short and limited lifespan through amendment in said Rule 7(4).

4.2.1.3. LOCK-IN PERIOD ON IPO ISSUE

- (a) Section 10 (1) of the Security Issue Regulation, 2008 states that pre-IPO shares of the promoters are subject to locked-in period for three (3) years post the IPO, which implies, sell of promoter share is restricted for a minimum period of three (3) years after the first public offering.
- (b) Section 7 of the Security Issue Regulation, 2008 states that body corporate should have undertaken the necessary works to meet its objective and completed one year life. The post-IPO lock-in and minimum time frame requirement for floating altogether makes up a lock-in period of four (4) years.
- (c) The lock in period up to four (4) years is too onerous to process exit for PE Fund which have limited and pre-determined lifespan of 8-10 years. Considering the limited lifespan of PE Fund, India and several other jurisdictions has relaxed the norms on lock in especially for PE Funds and VCF funds making lowering it to six (6) month to one (1) year.

4.2.2. PUBLIC SALE OF SECURITIES IN SECONDARY MARKET

PE Fund can exit from the investee companies through secondary sales at a market if the securities are listed in Stock Exchange subject to the terms and conditions mentioned in Rule 7 of the Security Issue Regulation, 2007. Conditions such as requirement to maintain 51% promoter's capital post the issue, pre-IPO lock in of more than one year from the date of operation etc makes it difficult for the PE Fund to plan one-time exit offloading all of its holding to general public. Apart from this, the fixed pricing of the premium shares is also an issue which creates an utter discomfort forcing the PE Fund to exit without being able to realize the exact value of their interest in Investee Company.

4.2.3. REDEMPTION OF DEBENTURES

PE Funds participating in the investee companies by way of non-convertible debentures can realize the value of debentures at a predetermined and agreed rate after expiry of certain period of time. However, this option is available only to the Onshore PE Fund. The restrictive approach of NRB on treating foreign loans makes it practically impossible for the Offshore Funds to make the investment in the debentures issued by Nepalese Companies. .

4.2.4. BUYBACK OF LISTED SHARES

PE Fund can exit from the investee company by selling its shares which are listed in Stock Exchange back to the investee Company. The same conditions applicable in Buyback discussed on paragraph 4.1.2 applies (needs to be satisfied) while opting for the buyback of listed shares. Although Section 61(4)(a) of the Companies Act, 2006 provides that Company may buy back its shares from secondary market, there is no provision in existing laws, *inter alia*, SEBON's Security Issue Regulations, 2007 and SEBON's Security Issue Guidelines, 2007 regarding the applicable procedures and conditions for buyback of shares from secondary market. This creates confusion in the PE Fund to implement their strategic exit plan.

4.2.5. DISPOSAL OF SHARES BY WAY OF PRIVATE PLACEMENT

PE Funds can exit from the investee companies by privately selling its holdings to fifty (50) numbers of investors²⁹. A company has an option to sell its shares by way of private placement up to fifty (50) number of investors, however, will need to float the shares in public if the sale of shares is intended for more than fifty (50) number of investors.

PE Fund can exit from investee companies by selling its holding to certain number of people through circular or offer method. Approval of the SEBON is a mandatory compliance requirement that needs to be fulfilled while opting for this method. Section 8 of the Security Issue Regulation, 2007 specifies the procedurals for this method. Pursuant to said Section, the issuer is required to submit the copy of General Meeting resolution, details as to the number of securities that will be issued, targeted investors, allotment procedures etc while making application to SEBON for private sell of securities.

Although Section 5 of the Issue Regulation allows the sale of security by private placement, the said regulation fails to outline the procedural requirements in details. SEBON may clarify the steps and procedures to obtain private placement approval and rule and procedures for issue, subscription, allotment post the approval.

4.3. OTHER RELEVANT ISSUES

Apart from the issues that PE Fund will face while adopting a particular exit route, there are certain other issues and regulatory constraints impeding the comfortable exit from the investee company. They are briefly discussed in paragraphs below;

4.3.1. VALUATION METHOD FOR PRICING OF SECURITIES

NRB and other authorities like Inland Revenue Department has not prescribed any pricing norms that would be applicable in the valuation of the security. This creates uncertainty on the method of valuation as different types of valuation method are practiced. Pursuant to the notification of NRB dated March 20, 2013, the valuation report of the assets and liabilities of the company selling its shares and interest should be submitted to NRB while obtaining the approval for repatriation of the divestment proceeds.

Notable economy in the SAARC region, including India has fixed the pricing norms on different basis for the listed securities and unlisted securities. While the price of the listed securities is based on average weekly price on the recognized stock market, the unlisted securities are valued/ priced on

²⁹ Pursuant to Section 29 of the Securities Act, 2003, a body corporate can sell its securities to fifty (50) number of on private placement and if it intends to sell its shares to more than fifty (50) person the shares should be floated for public sell.

negotiation. (Not less than the fair value as determined by registered Chartered Accountant or merchant banker registered with the security regulator.

In absence of any valuation norms, the regulator like the NRB may object to a valuation report prepared employing particular method of valuation showing the over pricing issue taking account of weak foreign exchange reserve. Similarly, a particular method of valuation may be objected with an intent to recover higher capital gain tax. For example, NRB may object the repatriation of the sale proceeds where securities are valued at Rs. 300 stating that if other valuation method were used the price per unit of security will be Rs.310 with an intent to recover maximum capital gain tax.

It is suggested that the NRB and other stakeholder should co-ordinate to prescribe the appropriate pricing norms for the valuation of the listed and unlisted security.

4.3.2. PROMOTER'S LOCK-IN

- (a) Section 10 (1) of the Security Issue Regulation, 2008 states that pre-IPO shares of the promoters are subject to locked-in period for three (3) years post the IPO, which implies, sell of promoter share is restricted for a minimum period of three (3) years after the first public offering.
- (b) Section 7 of the Security Issue Regulation, 2068 states that body corporate should have undertaken the necessary works to meet its objective and completed one year life. The post-IPO lock-in and minimum time frame requirement for floating altogether makes up a lock-in period of four (4) years.
- (c) The lock-in conditions virtually restricts all available public routes for the exit of PE Funds from the investee company within its short lifespan.
- (d) The lock in period up to four (4) years is too onerous to process exit for PE Fund which have limited and pre-determined lifespan of 8-10 years. Considering the limited lifespan of PE Fund, India and several other jurisdictions has relaxed the norms on lock in especially for PE Funds and VCF funds making lowering it to six (6) month to one (1) year.

A. Repatriation:

Repatriation of the dividend, interest, repayment loans, royalties, sale proceeds are important issues that concerns Offshore PE Funds after the exit. The convenience in the repatriation of the investment returns determines the entry of Offshore PE Funds in several ways.

The FITTA 1992 permits the foreign investors making investments in foreign currency are entitled to repatriate investment returns and incomes from Nepal³⁰. However, there are some practical issues that concern the repatriation process in Nepal and severally affect the Offshore PE Funds. Foreign Investors including the Offshore PE Funds are required to obtain

³⁰ Section 5 of the FITTA states that the foreign investors investing in Nepalese company can repatriate the interest, dividend, amount of loan repayment and sale proceed from Nepal.

recommendation from the Department of Industry and approval from the NRB before they can repatriate the income and investment returns (service fee, royalties, loan repayment, interest, sales proceeds etc) .

The requirement to undertake process before more than one authority does not have any sense. While the requirements for obtaining repatriation approvals may have its own justification on the right of the central bank to have control over foreign exchange reserve, the requirement to obtain recommendation of DOI does not have any justification.

Obtaining the approval for repatriation of the dividend, divestment proceeds may take as much as ninety (90) days even after lobbying and continuous follow up. The delayed process gives a sense to the Offshore PE Funds the fund will be trapped once it comes in. Offshore PE Funds willing to test the water in Nepal will not come to invest in Nepal.

Repatriation of Loan and Interest to the Foreign Lender (including Offshore Fund) is the area seriously plagued by the protectionist approach of NRB. Pursuant to the NRB circular dated September 11, 2013, a borrower in Nepal cannot repay the foreign loan if - (a) it is blacklisted before Credit Information Centre Limited, or (b) any it has any payable debt to local banks and finance Company. The said provision puts the interest of the Offshore PE Fund to recover the foreign loan in a situation of absolute jeopardy. Apart from this the said conditions also rescind the modern practice of loan investment through subordinated debt function and the consortium partnership of foreign lenders and local Banks and Financial Institutions.

The restrictive conditions may also be used by the Investee Company in Nepal to avoid the repayment of loan to Offshore PE Fund. For example, an investee company in Nepal may avail the recurring loan facility with local banks or financial institution to assert that it has the debt payable to loan facility.

CHAPTER FIVE: TAX ASPECTS OF THE PRIVATE EQUITY IN NEPAL

The matters related to income tax and capital gains are dealt with by-(A) Income Tax Act, 2002 (2058) (the "**ITA, 2002**"), and (B) Income Tax Rules, 2003 (2059) (the "**ITR, 2003**"). The Inland Revenue Department (the "IRD") is the government authority which is tasked for tax administration. The Partnership Act 1964 provides provisions only for formation of partnership with unlimited liability and partnership as a business vehicle with limited liability partnerships is not available. The Partnership Act further limits the number of members to 20 and only natural persons can form partnerships. The Companies Act provides deals with incorporation of limited liability companies and provides for incorporation of private limited companies, public limited companies and not for profit companies. The number of shareholders is limited to 50 in case of private limited companies.

The ITA, 2002 does not provide a pass through of taxes for partnerships as common in other jurisdictions and imposes tax on both the partnership firms and companies in a similar manner. The taxable income is subject to the corporate tax (normal corporate tax currently being 25%) and any distributions made to beneficiaries (or shareholders) are subject to tax at the rate of 5% on withholding basis. Section 56 of the ITA, 2002 however, exempts the dividend income from further taxation so that it prevents taxation when the dividend is paid further towards the holding level.

The ITA, 2002 imposes tax both on the basis of (a) residence and (b) source principal. Most of the payments are subject to withholding tax at various rates. Following provides certain payments made by resident entities in the form of interest.

The ITA, 2002 does not provide any specific exemption or benefit to the VCFs. Following is recommended to address some of the issues related to VCFs:

5.1. TAXATION IN CHANGE OF OWNERSHIP

- a) Section 57 of the ITA, 2002 provides that if the ownership of any entity changes by 50% or more within a period of 3 (Three) years, then such entity will be deemed to have disposed of its assets or liabilities. Pursuant to Section 57 of the ITA, 2002, change of ownership by 50% or more will trigger the following:
 - i. separate accounts will have to be prepared for the period up to the change in ownership and after the change in ownership,
 - ii. the assets and liabilities of the entity will have to be evaluated at market price and the entity will be subject to tax on any gain amount (at the rate of the tax applicable on business income), and
 - iii. the entity will not be able to carry forward the losses, and such other restrictions outlined in Section 57(3) of the ITA, 2002 will be applicable.
- b) VCFs will need to be provided specific waivers from the requirement of Section 57 of the ITA, 2002. It may be noted that the Government of Nepal had introduced targeted waiver for banks

and financial institutions from the requirement of Section 57 to encourage merger and consolidation of financial sector.

5.2. DOUBLE TAXATION TREATY

- a) Nepal has entered into double taxation treaty with ten countries. It is also understood that the Government of Nepal is working towards covering double taxation treaty with additional countries.
- b) In practice, however, the intended beneficiaries under the DTA are not able to receive the double taxation benefits provided under the DTA due to wrong application of the DTA by the IRD. The IRD should set-out the written guidance on applicability of the DTA and situation where payments from Nepal will not be subject to the withholding tax requirement.

5.3. GUIDANCE ON TAXATION OF HYBRID INSTRUMENTS

- a) It is expected that with development of VDFs and new investment opportunities in Nepal, the use of hybrid instruments are likely to increase. The use of hybrid instruments in Nepal is not common and their tax treatment does not have any legislative or regulatory guidance. ITA, 2002 provides substantial difference in treatment of interest and equity. While the ITA, 2002 follows the common principle that interest can be charged as expenses and distribution of equity not chargeable as expenses, it subjects payment of interest to withholding tax at the rate of 15% (except where the payment is made to licensed banks and financial institution) and that for distribution for equity is 5%.
- b) The financial impact for re-characterization of any transaction from equity to debt or debt to equity is likely to be substantial. The IRD should set-out a written guidance its view for tax treatment so as to provide predictability for use and structuring of the hybrid instruments which should meet the commercial objective of the investors and need of the investee entities.

5.4. FINALITY OF WITHHOLDING TAX

- a) Section 92 of the ITA, 2002 provides final tax treatment for certain payments on which tax has been withheld. The payment falling under Section 92 of the ITA, 2002 are treated as finally taxed and no additional tax is incurred. Pursuant to Section 92(f) of the ITA, 2002, payments made to the non-resident which are subject to withholding tax under Sections 87, 88 and 89 shall be regarded as finally taxed. Section 88 of the ITA, 2002 covers, amongst others, withholding tax for payment of service fees and interest. Therefore, payments made to the Fund in the form of service fees, interest will be regarded as finally taxed under ITA, 2002.
- b) The provision related to withholding of tax on capital gain tax is provided by Section 95A of the ITA, 2002. Section 92 of the ITA, 2002 which provides list of payments which shall be treated as final, does not include payments made under Section 95A.
- c) The VCFs should be provided finality of taxes.

CHAPTER SIX: ISSUES AND RECOMMENDATION

The key issues that are hindering the effective and smooth entry, operation and exit of the PE Funds are listed below along with the identification of the area of the reforms:

Issues	Problem	Implications	Reform	Instrument of Reform	Authorities Responsible to carry out Reform
A. ENTRY					
A.1 Short Term Reforms					
1. No blanket approval for foreign direct investment	As per the prevailing practice, government approvals are required at least for- (a) each investment by the Offshore PE Funds in each portfolio companies in Nepal, (b) each instances of increase in investment by the Offshore PE Fund in Nepal, (c) each instances of exit and divestment of the offshore fund from each	<ul style="list-style-type: none"> Increases costs of investments and divestments and delays the overall investment and divestment processes. Not compatible with the limited life span of the Offshore PE Funds. Impedes convenient sale and purchase of Portfolios and interest owned by PE 	Formulate the rules/circulars on blanket Approval modality for foreign investments and divestments by specifying the permissible sectors, total investment, minimum and maximum thresholds on one-time investment or divestment.	<p>Policy decision by IPB on such blanket approval and implementation by DOI by making necessary provisions in the Procedural Manual for Foreign Investment.</p> <p>Introduction of the new circulars by NRB to specify the necessary requirements and conditions for blanket approval process (up to</p>	NRB IPB and DOI

	<p>portfolio companies in Nepal;</p> <p>(d) each instances of reinvestment of dividend-return by the Offshore PE Funds.</p>	<p>funds in their targets.</p>		<p>certain limits) by way of notification or circular under Foreign Exchange (Regulation) Act 1962 (2019).</p>	
<p>2. Duplications in approvals</p>	<p>Approvals for foreign investment or divestment are required from at least -(a) approval from DOI/IPB/Investment Board, and (b) approval from NRB for each instance of investment or divestment</p>	<ul style="list-style-type: none"> Increases costs of investments and divestments and delays the overall investment and divestment processes. Potential PE Funds investors will lose their confidence for investing in Nepal fearing the cost of divestments and delay in the approval process. 	<p>Reform the present One-Window-Practice to facilitate the potential foreign investors by providing them with the opportunity to -(a) obtain investments and divestments approval (b) tax registration (c) environment clearance (d) company formation, at a single place.</p> <p>Implement the provisions pursuant to which-(a) an approval from DOI only be required for making investments, and (b) notification to NRB about such inflow foreign capital should be sufficient.</p> <p>Implement the provisions pursuant to which -(a) an</p>	<p>Making necessary provisions in the NRB circulars</p> <p>Decision by IPB</p>	<p>NRB</p> <p>One-Window-Committee</p> <p>IPB/DOI</p>

			approval from NRB only be required for divestment and repatriation of the returns and exit proceeds, and (b) notification to DOI about such outflow foreign capital should be sufficient		
3. Minimum Capitalization Requirement ("MCR")	<ul style="list-style-type: none"> Both of the FITTA, 1992 and FERA, 1962 does not provide the minimum amount of foreign investments that a foreign investor is required to make in Nepal. However, MCR at the present has been fixed as NRs. 5 million irrespective of the sector of business. In view of such requirement, the offshore fund will need to make investment of at least of Rs. 5 million in each portfolio companies. 	<p>The minimum capitalization requirement restricts the Offshore PE Funds to invest in Small and Medium Scaled Enterprise along with start-up ventures capital undertakings.</p> <p>The Offshore PE Funds will not be able to freely determine the amount to invest in the targets/ portfolios in Nepal.</p> <p>Onshore PE Funds will not able to attract and pool the amount below Rs. 5 million</p>	Withdraw the Minimum Capitalization Requirement identifying the prioritize sectors including SMEs and PE Funds investment in Venture Capital Undertakings and start-up companies in Nepal.	IPB may make decision in this regard.	a.DOI

		from foreign investors and may not be able to work as an investment vehicle.			
4. "Negative List" and "Positive List"	<ul style="list-style-type: none"> As per the law, foreign investment is permissible in all sectors of businesses except the sectors falling under negative list of FITTA, However, as per the prevailing practice, foreign investment is allowed only on those sectors which have been identified and categorized as the industrial sector under the Industrial Enterprise Act 	<ul style="list-style-type: none"> Only few and limited sectors are open for foreign investment in reality when only few sectors are restricted as a matter of law. This has rendered the foreign investment regime of Nepal completely unpredictable. 	Prepare consolidated and exhaustive list of areas of business open and closed for foreign investment.	Publication of the Gazette notification clarifying that the industries classified under the IEA 1992 are illustrative only and foreign investments is permissible in all sectors of industries except those specifically restricted by the FITTA 1992 or other sector specific laws.	IPB

	<p>1992 (the "IEA 1992").</p> <ul style="list-style-type: none"> • In addition, the authority has been taking inconsistent approach in dealing with foreign investment approval by invoking different policy requirements in different cases. 				
5. Investment in micro finance and micro insurance sectors	<p>NRB and Insurance Board permit foreign entities to make investment in the micro-finance and insurance businesses respectively only if the foreign entity is registered/ licensed as a financial institution or insurer in their country of incorporation/operation.</p>	<p>Offshore PE Funds will be restricted from making investment in Micro Finance and Micro Insurance sectors.</p>	<p>Permit the foreign investments by the offshore PE funds in the micro finance and micro insurance services.</p>	<p>Amendment to the existing licensing policy and notification by the NRB and introducing the directive by the Insurance Board</p>	<p>NRB Insurance Board Ministry of Finance</p>
6. Differential Taxation	<p>Taxation on Gains from short-term and long-term (over 3-5 years)</p>	<p>Institutional (private equity funds) as well as individual</p>	<p>Taxation on gains from long-term investments at lower rate than that on gains</p>	<p>Amendment in Tax Act of Nepal to differentiate</p>	

on Gains on long term Capital Investments	investments isn't differentiated.	investors aren't incentivized to go for long term investments. Bottleneck in long-term capital formation.	from short-term investments.	taxation on gains on long-term and short-term investments	
7. Sectors open for Onshore Funds Investment	<p>Gazette Notification dated May 16, 2011 has included the "Investment Company having objective to carry out investment activities, investment business, and development of infrastructure and industrial sector" as a service industry under the Industrial sector of IEA 1992.</p> <p>There is no guidance in the said notification and other existing laws as to clarify what particular activities were contemplated to be covered under (a) investment activities (b) investment business.</p>	The ambiguity in the area to be covered under the -(a) investment activities, and (b) business activities may lead to multiple interpretations limiting the scope of the offshore funds and onshore investment vehicles to carry out investment activities and investment business.	<p>The existing ambiguity may be resolved by Industrial Promotion Board through clarifications.</p> <p>Such clarifications should exhaustively list out the investment options for Investment Company in the form of 'permitted investment options ' and 'restricted / prohibited investment options'.</p> <p>Such clarifications should also cover the investment instruments that both the offshore PE fund and onshore PE fund may use for making investments in the multiple targets.</p>	Clarifications by the IPB by publishing notice in the Nepal Gazette	IPB

8. Regulation of Foreign Loan by NRB and Limited Investment Instruments	<u>a. Obtaining of Foreign Loans:</u> NRB has been taking restrictive approach to allow the companies in Nepal to avail foreign loans. A company in Nepal can obtain approval for foreign loans only when -(a) the loan cannot be obtained from domestic banks and financial institution, and (b) the rate of interest is lower than the interest rate in practice of domestic banks and financial institutions.	Domestic borrowers must resort/ approach to the local banks and financial institutions for borrowing loans and be rejected before they can approach/resort to foreign lenders as well as the Offshore PE Funds. Offshore PE Funds may not invest in portfolios and ventures of Nepalese targets by way of the Shareholder Loan.	Revise the existing circulars/notifications on the foreign loan and interest rate in order to allow the domestic borrowers to avail foreign lenders including the Offshore PE Funds.	Amendments to the existing circular/notification issued by the NRB	NRB
	<u>b. Repayment of foreign debt:</u> The resident borrower availing foreign loans are not allowed to service their foreign debt so long as they are - (a) blacklisted for default of any loan obtained from local banks and	Local Bank and Financial Institutions in a superior position than the foreign lenders to in securing loan repayment putting the interest of foreign lenders in absolute jeopardy. This	Revise the existing circulars/notifications on the foreign loan and interest rate in order to ensure the equal treatment to both the local and foreign lenders and to fix the payment priority consistent with the terms of the loan and security documents entered between the	Amendments to the existing circular/notification issued by the NRB	NRB

	<p>financial institutions in Nepal, (b) they have matured loan payable to banks and financial institutions in Nepal.</p>	<p>discriminatory treatment to the foreign lenders will operate as an effective deterrent to the foreign lenders including the Offshore PE Funds investing through loan in portfolios of the targets in Nepal.</p> <p>This also impedes the practice lending of sub-ordinate debts among borrowers and foreign lenders and domestic lenders.</p>	<p>local/foreign lenders and the borrower.</p>		
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	<p><u>c. Limited Investment Options available to Nepalese Companies:</u></p> <p>Section 47 of the BAFIA has included 'lending' within the meaning of the "Financial Transactions". Similar provision is also provided in the NRB Act.</p> <p>Carrying out or undertaking financial transaction is reserved only for the licensed Banks and Financial Institutions under Section 28 of the BAFIA.</p> <p>NRB has currently been restricting the onshore funds to provide loan or use debt instruments in the targets.</p>	<p>This has restricted the use of the debt instruments by the onshore funds.³¹</p>	<p>Exempt investment company in Nepal along with Onshore PE Funds from the restriction to invest in the targets by way of loan and grant the approval for loan investments in the targets.</p>	<p>Issue and implement the circulars permitting</p>	<p>NRB</p>
A2. Long Term Reforms					

³¹ However, the government owned Hydropower Investment and Development Company Limited ("HIDCL") has been allowed by NRB to invest loan in the Hydropower Companies in Nepal.

1.Comprehensive Framework for Regulation of the PE Funds.	The requirements and laws applicable in the context of setting up, operation and exit of the PE Funds, are scattered throughout various Acts, Rules, Notifications, and Circulars etc.	Absence of the comprehensive regulatory framework to deal with PE Funds has created the practical problems and has also been a source of uncertainty and unpredictability to the investors. The issues like restriction in making matter of foreign loans, repayment of foreign debt, and ambiguity within the meaning of so-called permitted Investment Company lies as caveats which concern the successful operation of PE Funds.	Issue and implement a comprehensive regulatory framework which sets out the legal provisions relating to entry, operation and exit of the PE Funds. All the short terms reforms identified in the above section should also be incorporated in such legal instruments.	NRB, DOI, IPB along with other concerned regulatory can study and recommend about the permissible areas, permissible entry and exit routes etc to the law ministry.	(a) Council of Ministers (b) Legislative Parliament
2.Allow Issuance of Debentures by companies without limitation to subscribe 100% of equity shares	Companies can only issue secondary instruments after the first instrument issued is fully paid and the company is making profit. For large companies, especially infrastructure companies, cannot make profit for initial years, it is	As infrastructure projects are capital intensive, companies need to raise capital apart from the initial share equity put in by the promoters. These companies are forced to go for loans as debt financing rather than issuing debentures during the initial years.	Allow larger infrastructure projects (Capital size over 10 billion) to issue debentures after getting approval for the project from concerned governmental bodies.	Amendment in Regulations concerning secondary issue by infrastructure companies by Company Act/ SEBON to allow them to issue debentures from Day-1	

	impossible to raise money via debentures during this period.	This has led to lack of growth in debenture market, which in turn bars companies as well as private equity funds from alternative investment instrument.			
3.Allowance of Flexible Capital Structure	<p>Only two categories of shares: promoter and ordinary. Minimum of 51% promoter share holding. For large companies, especially infrastructure projects, getting 51% promoter holding at existing scenario is very hard, especially due to the three year lock in period and absence of issuance of shares at market pricing.</p> <p>In absence of flexible capital structure companies are not able to form different shareholder structure with differential rights</p>	<p>The lock-in period for promoter without additional benefit in IPO pricing creates reluctance among institutional investors like private equity funds to participate in these projects as promoters. This in turn limits the size of projects, especially infrastructure projects, that can be undertaken by private sector.</p> <p>With flexible capital structure, company can source required capital as per need and also introduce Employee Stock Option to</p>	Allow creation of different categories of shares within the promoter and ordinary share groups. Treatment of these categories in terms of minimum percentage holding, lock-in period, board composition and accountability of operations should be identified/amended.	Amendment in Company Act/“Securities Registration and Issue Regulation” to define various categories of share investments and allow flexible equity structure using these categories of share instruments.	

	that are necessary to attract funds at different level of project development	incentivizing working employees			
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B. Operation

B.1. Short Term

1. Restriction under Section 176 of the Companies Act	As investment companies have not clearly been exempted from the restriction provided under Section 176 of the Companies Act. Section 176 may also be interpreted that the onshore fund cannot make investments in or provide loan to the portfolio companies in excess of its-(a) 60% of the sum total of the paid up capital and free reserve, or (b) 100% of the free reserve whichever is higher.	The restrictions in making investment above 60% of the paid up capital seriously impedes the working of the PE Funds. As the amount pooled in PE Funds are usually higher than the amount shown as paid up capital in the time of incorporation, the restriction in making of investing beyond 60% of the paid up capital will	Clarify that the "company with the main objective of buying and selling securities" also includes the PE Funds.	Issuance of the Directive by OCR for the clarification pursuant to Section 16(2) of the Companies Act	OCR
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	<p>However, the proviso to said section exempts the Investment Company with objective to purchase and sell securities.</p> <p>However, lack of any clarifications on the meaning of 'investment company with the objective to purchase and sell securities' has added confusion and PE Funds cannot find themselves comfortable.</p>	<p>resulting into the freezing of the amounts collected in the PE Funds.</p> <p>There is no guidance on existing law as to whether the PE Funds qualifies to be taken as 'Investment Company with objective to sell and purchase securities'.</p> <p>This has lead to confusion whether the PE Funds can operate inside Nepal as an Investment Company and be exempt from said Section 176 restriction.</p>			
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2. Approval requirement for each instance of further/additional investment	<p>As per the prevailing practice, government approvals are required at least for-</p> <p>(a) each investment by Offshore PE Funds fund in each portfolio companies in Nepal,</p> <p>(b) each instances of increase in investment by the Offshore PE Fund in Nepal,</p> <p>(c) each instances of exit and divestment of the offshore fund from each portfolio companies in Nepal.</p> <p>(d) each instances of reinvestment of dividend-return by the Offshore PE Funds.</p>	<ul style="list-style-type: none"> Increases costs of investments and divestments and delays the overall investment and divestment processes. Not compatible with the limited life span of PE Funds. Impedes convenient sale and purchase of Portfolios and Interest owned by PE funds in their targets. 	Formulate the rules/circulars on blanket approval modality for further or "add-on" foreign investments by specifying the permissible sectors, total investment, minimum and maximum thresholds on one-time investment or divestment.	<p>Policy decision by IPB on such blanket approval and implementation by DOI by having necessary provisions in the Procedural Manual for Foreign Investment.</p> <p>Introduction of the new circulars by NRB to specify the necessary requirements and conditions for blanket approval process (up to certain limits) by way of notification or circular under Foreign Exchange (Regulation) Act 1962 (2019).</p>	<p>NRB</p> <p>a. IPB and DOI</p>
3.Blacklisting	Provision on blacklisting in NRB's Unified	PE Funds typically invest in portfolios of	Exempt the Onshore PE Funds from the blacklisting risk	Amendment to the existing Directive on	NRB

	<p>Directives provides that - (a) directors, CEO and body corporate holding more than 15% share in the defaulter company (b) body corporate having less than 15% shareholding in the defaulter company, however, having the controlling interest (c) directors including nominee directors in the defaulter company -must be recommended for blacklisting.</p> <p>The Directive on the Blacklisting has exempted the "foreign investor" from the blacklisting. However, the blacklisting provisions will apply to the onshore funds.</p>	<p>diverse sectors. The risk of the investee targets being in default to service debt to the licensed banks and financial institutions can be expected.</p> <p>While a single PE Fund invests in more than 100 numbers of portfolios there is always a possibility of 1 or 2 portfolios out of 100s being in default to service the debt.</p> <p>An entity will be left with limited or virtually no option after being black listed in business, it can neither avail any further loan nor can it raise money from public.</p> <p>While these rigorous provisions to</p>	<p>considering the investment nature of the PE Funds, like it has been given to the Foreign Missions, foreign firms/corporation partnering under foreign investment, foreign donors and development partners etc.</p>	Blacklisting.	
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		<p>the defaulter may have its own justification in case of regular business, it poses a serious risk to the PE Funds which by its very nature and purpose invest in portfolios and undertaking of diverse sectors and one or two wrong choice in selecting the portfolios/ undertakings will end the business of total PE Funds.</p> <p>Even the investor investing in the PE Funds by way of loan, equities or other instruments will be in constant risk of losing their money for a single or two wrong choice(s) of PE Fund.</p>			
B2 Long Term					

4. Penalty driven filing requirement	<p>Directors and officers of the companies which fail to submit the annual returns and other compliance documents are personally liable to pay fine to the OCR prescribed on the basis of-(a) amount of the paid up capital, and (b) time of delay.</p> <p>As the companies are subjected to multiple filing and reporting requirements annually, amount of the fine would be higher. Further, the court can also convict the directors and officers with a fine of up to NRs. 50,000 and imprisonment for up to 2 years or both for non-compliance with the periodic filing and reporting requirements.</p>	The multiple filing and reporting requirements and consequential personal liability of the directors and officers for non-compliance is likely to deter the offshore funds and onshore fund to nominate the appropriate individuals to act as a director in the onshore fund/portfolio companies and participate in the management activities.	Simplify the filing and reporting requirements especially the PE Funds and targets registered as a private company.	Amendment to the Companies Act 2006	<p>Council of Ministers</p> <p>Legislature Parliament</p>
5. Strict liability of	The Companies Act provides for	Companies Act restricts any	Rationalize the liability of the	Amendment to the Companies	Council of Ministers

the directors	<p>strict personal liability of the directors for non-compliance with the provisions of the Companies Act. The sanction provisions range from fine of NRs. 50,000 to imprisonment up to 2 years.</p>	<p>company to indemnify directors against the personal liability. Moreover, the director's liability insurance policy cannot be easily purchased from local market. Strict liability on the part of directors and absence of any cushion may impede the taking of strategic-yet-risky decisions and some qualified directors may find it difficult to seat in the Board.</p> <p>Both Offshore and Onshore PE Funds may find it difficult to find qualified persons willing to represent themselves in the portfolios of their targets.</p>	<p>directors especially those appointed in the targets which are registered as a private company.</p>	Act 2006	Legislature Parliament.
6. Limitatio	Any decisions on investing of the	Customarily, the decision to	Exempt the Onshore PE Funds from such	Amendment to Section 95(6)	Council of

n on Delegatio n of Authority (Restricti on under Section 95 (6))	<p>funds of the company or providing loan should be made by the Board of Directors and such authorities cannot be delegated to the management by the Board of Directors.</p> <p>The Companies carrying out banking and financial transactions are exempted from this restriction. However, the restriction will apply to the board of directors of the onshore funds..</p>	<p>invest in the portfolios or targets by way of loan or equity out of amount available in PE Funds is taken by qualified investment manager and making of investment decision to invest money in the PE Funds day to day affairs in PE funds.</p> <p>It is practically difficult for the Board of Directors of the PE Funds to pass the resolution to invest out of the amount available on the PE Funds.</p>	restriction.	of the Companies Act	Ministers Legislative Parliament
7.Develop ment of different investmen	Limited investment tools in the market for investors to	This limitation makes institutional investors like	Inclusion of development of different investment tools for institutional	Amendments by SEBON in its regulations for allowing	

t tools which include forming securitization of cash flows that can provide investment instruments for general public	diversify risk and expected returns.	PE funds reluctant to enter the market, thereby depriving the market with an essential market maker.	investors like income participatory instruments and securitized instruments by SEBON in its policy.	and developing these different investment tools.	
8. Settlement of Disputes	FITTA s restricts the parties to the foreign investment agreement in choosing the governing law in the event of dispute. The parties to the foreign investment agreement are free to independently choose the governing law only if the amount to be invested under the foreign investment agreement exceeds Rs. 500,000,000 ³²	Even the arbitration proceedings in Nepal are plagued with delays and formalities. Appeal against the verdict of arbitral panel are brought and entertained in courts defeating the very purpose of arbitration. In addition to this, the risk of nationality bias cannot be out ruled. The higher	Revise the minimum foreign investment threshold applicable to determine the choice of law. Allow Offshore PE Funds to choose the governing law considering the limited life span and time-consuming arbitration practice in Nepal.	As the present FITTA is expected to Replace the Draft FITTA, revision in the Draft FITTA can be done by law ministry before tabling the bill in legislature-parliament.	Council of Ministers Legislature-Parliament.

³² 1 USD = Rs. 96.42

	(Five Hundred Million Nepalese Rupees). Draft FITTA which is expected to replace the present FITTA has even proposed to increase the said threshold to USD 10,000,000 (Ten Million US Dollars) which is equivalent to Rs. 964,200,000 (Nine Hundred Sixty Four Million Two Hundred Thousand Nepalese Rupees) at the current exchange rate.	threshold for the foreign investor to be able to choose the governing law on arbitration and the delayed arbitration proceedings in Nepal can be taken as threat by the Offshore PE Funds investors to invest in portfolios and ventures of Nepalese targets as the life of PE Funds are usually short and the prolonged dispute settlement proceedings can continue can exceed the lifespan of PE Funds.			
9. Clarity on issues regarding accounting/redemption/conversion of preferred shares (plain as well as	Company Act has allowed issuance of Preferred Shares but has not clearly stated terms for convertible and cumulative preferred shares especially the case of settlement	Preferred shares are widely used instruments for Private Equity fund that can demand fixed payment from the target company but also ensures	Clearly stipulate terms of offer of preferred shares and procedure for its redemption either in cash or vide in kind. Also stipulate terms of payment of accrued preferred divided either in cash or in kind after the conversion/payment	Addition of terms of issue of preferred shares in Company Act/ clarity on tax implications by Tax Act/and respective provision in the Securities	

convertible and cumulative)	of accrued cumulative preferred dividends	such company is protected from default and subsequent bankruptcy	of principle of preferred shares	Regulations	
C. Exit					
C1. Short Term					
1. Duplication in Approval Process	<p>Government approvals are required for each exit and divestment of the offshore fund from each portfolio company in Nepal.</p> <p>Offshore PE fund cannot obtain a single/in principal approval for the exit and divestment for multiple portfolios in diverse sectors.</p>	<p>An Offshore PE Fund investing in multiple and diverse portfolios is required to file for and obtain several approvals to divest its investment and take back.</p> <p>The requirement to obtain the approval for divestment does not have any justification and it is not necessary in practical sense.</p> <p>This has increased the costs of divestments and delayed the</p>	Formulate the rules/circulars on blanket Approval modality for foreign divestments.	<p>Policy decision by IPB on such blanket approval and implementation by DOI by having necessary provisions in the Procedural Manual for the Foreign Investment.</p> <p>Introduction of the new circulars by NRB to specify the necessary requirements and conditions for blanket approval process (up to certain limits) by way of notification or circular under Foreign Exchange (Regulation) Act 1962</p>	NRB IPB and DOI

		overall divestment processes and will be treated as caveats by Offshore PE Funds while investing in portfolios of Nepalese Targets.		(2019).	
2. Valuation requirements	<p>Pursuant to a public notice issued by NRB dated May 29, 2012, a valuation report of the assets and liabilities is required to be submitted to NRB for repatriation of the foreign investment/sale proceeds.</p> <p>However, no detailed valuation processes and criteria have been set out yet.</p>	<p>Absence of valuation guidelines has created uncertainty as to the valuation method to ascertain the value of per unit of security.</p> <p>As more than one popular method for valuation of the security and method of valuation is not prescribed till date, the regulator like NRB may object to particular method of valuation taking protective approach taking in account the limited foreign</p>	<p>Issuance of the details guidelines on method of valuation of listed and unlisted security should be published by NRB. IRD should also be made involved as revenue stakeholder while preparing the guidelines for valuation of the security.</p> <p>Specify the threshold of the amount of repatriation which are not subject to valuation requirements.</p>	Issuance of the Circulars by NRB and IRD	NRB IRD

		exchange reserve (.			
3. Relaxation in Lock-in-period norms.	All pre-IPO equity investors in non-financial institutions are unable to exit their investments for three years post-IPO, regardless of whether they are promoters or purely financial investors such PE Funds.	This will severely limit the exit option and timing of the fund as promoter of the portfolio companies. The pre-IPO lock in for three (3) years and post IPO lock-in for three years to promoters forbids the PE Funds to exit from their portfolios for a minimum period of six (6) years will severely hampers the PE Funds which typically have short lifespan.	Lower the lock in period for pre-IPO shares may be lowered to one (1) year or six (6) month particularly in the case of the PE Funds.	Amendment to the Security Registration and Issue Regulation, 2065 and Security Issue Guidelines, 2065.	SEBON
C2 Long Term					
4. Restriction on Issuance of Shares at premium	<ul style="list-style-type: none"> A listed company cannot issue shares above the net worth per share determined on the basis of the financial audit of the company. Further, the distribution of dividend for 3 	Due to said restrictions, the company cannot publicly issue its shares at premium rate even if the return on equity of its shares	Move to a market-pricing mechanism such as book building SEBON would still need to approve valuation before IPO, thus they retain control over the issue of inflated pricing being a danger to retail investors.	Amendment to Section 29 of the Companies Act, 2006.	Council of Ministers Legislature Parliament

	<p>consecutive financial years is another criterion that both the listed and other companies are required to satisfy for the issuance of the shares at premium.</p> <p>In case of the listed company, the current regulation forces many firms to issue IPO shares at a fixed value (e.g. Rs100), or as per the proposed regulation at a maximum of 2.5 times Net Worth of the company.</p>	<p>appears to be promising for substantial period of time.</p> <p>While the 3-year track record for distributing profits may be a condition necessary to protect the interest and also serve the assurance of general public, the said conditions/restrictions does not holds good in every companies.</p> <p>PE funds investing in ventures capital undertaking cannot exit from targets even if target is matured enough to operate on its own and both the PE funds and the targets may not be able to derive the maximum return.</p>	<p>Further, specific exemption for issuance to sophisticated investors should be provided as such investors do not need such level of regulatory protection This will require amendment to Section 29 of the Companies Act 2006 (2063) in long run.</p> <p>Amend Section 29 of the Companies Act to apply the provision only to the listed companies.</p>		
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		<p>If the company shares are worth more to the market than the price cap imposed, founders and other shareholders would need to sell shares at a discount to their real market value. Very few entrepreneurs are prepared to do this which limits the variety of sectors and companies listed, and minimizes the benefit of having more companies comply with the reporting and transparency requirements of a listing. It also penalizes companies with low fixed assets but high growth (e.g. a software or service company) whose valuation on a multiple of net worth would be</p>			
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		small, but may be high value job generators for the Nepal economy.			
5.Allow Divestment to public	<p>IPO is considered only with issue of new shares. However, company may plan to go public without any need to raise capital but bring potential source of investments for future projects.</p> <p>Initial investors may wish to liquidate portion of their holdings by selling their shares to public. So, that capital becomes liquid and Initial investors (promoters) can undertake further entrepreneurial investments.</p>	Institutional investors like PE funds cannot divest their investments to public before the end of lock-in period, even though there maybe potential investors. This severely limits the exit options of institutional investment funds like PE funds.	Allow divestment of holding up to certain limit by institutional investment funds like PE funds via offer document or through IPOs to public.	Categorize divestment of existing shares to public also as IPO.	
6.Buyback of Shares	The Companies Act states that buy back of shares can be done only with the free reserves of the	Limitation on exit options for PE funds. PE funds have to wait for companies to	Allow buy back of shares of institutional investment funds like PE funds by the companies through asset sale as or	Amendment in The Companies Act on restrictions made for buy back of shares	

	<p>company.</p> <p>Only existing promoters can buy shares of another promoter but not the company itself.</p>	<p>make cumulative profit before buyback of their shares by the company.</p> <p>Or, need to depend on the other promoters to buy their shares</p>	<p>through leverages based on capitalization plan and on agreement from the lenders</p>	<p>by companies. Allow to buy back shares through LBOs even if the company isn't making cumulative profits but is promising.</p>	
<p>7. Limitation on the source of the fund for redemption of the preference shares</p>	<p>The Companies Act permits the redemption of the redeemable preference shares only from-(a) distributable profits, or (b) share money received from the fresh issue of the shares which is specifically issued for the redemption of the shares.</p>	<p>If the portfolio companies are not operating in profit and is in loss, then such portfolio companies would not be able to redeem the redeemable preference shares subscribed by the offshore fund or onshore fund.</p> <p>This will block the exit of the PE Funds from their portfolios which are in loss.</p>	<p>Permit the targets/ portfolios that have received issued redeemable preferential shares to the PE Funds to redeem their preference shares to an extent of 100% of their paid up capital out of sale proceeds of investment and assets and not necessarily out of free reserves or security premium account in view of easing the exit of PE Funds from targets.</p>	<p>Amendment to Section 65 (5) of Companies Act.</p>	<p>Government of Nepal Legislature Parliament.</p>

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ANNEXURE

Annex 1

Rate of Withholding Tax

S.N	Heads of Withholding Tax	Rate of Withholding Tax
1	Interest Payment having source at Nepal, Payment for use of Natural Resources, Royalty, Service Fee, and Retirement Payment from Approved Retirement Fund.	15%
2	Gratuity and Provident Fund Payment from approved Retirement Fund.	6%
3	Dividend, Profit from Investment Insurance, and Profit from Unapproved Retirement Fund.	10%
4	Payment for Construction Contract and Contract.	1.5%

Annex 2

Negative List for Foreign Investment

<i>Schedule A (which can be amended by the Parliament)</i>	<i>Schedule B (which can be amended by the Government)</i>
1. <i>Cottage industries</i>	1. <i>Retail business except those retail businesses operating as an international chain in more than 2 foreign jurisdictions</i>
2. <i>Personal service business (such as hair cutting, beauty parlor, tailoring, driving training etc)</i>	2. <i>Tobacco Leaf (Bidi) industries (except those industries exporting more than 90%</i>
3. <i>Arms and ammunition industries</i>	3. <i>Domestic courier service</i>
4. <i>Explosives, Gunpowder</i>	4. <i>Atomic energy</i>
5. <i>Industries related to Radio-active materials</i>	5. <i>Poultry farming</i>
6. <i>Real estate business (except construction industries)</i>	6. <i>Fisheries</i>
7. <i>Motion picture industries (produced in national languages)</i>	7. <i>Bee-keeping</i>
8. <i>Security printing industries</i>	8. <i>Consultancy services and other businesses such as management, accounting, engineering and legal businesses except the consultancy services having maximum 51% foreign investment.</i>
9. <i>Currencies and mint industries</i>	9. <i>Beauty Parlor</i>
	10. <i>Local catering services</i>
	11. <i>Village tourism</i>

Annex -2A

Negative List of Foreign Investment under Draft FITTA

-Micro Enterprises and Traditional Cottage Industries

- Arms and ammunition industries

-Real Estate Business (except the Construction)

-Mint and Coin Business

-Multi Brand Retail Business having less than Rs. 5,000,000,000 (Five Billion Nepalese Rupees)

-Hotels with less than three (3) star status

-Tour Guide and Operation

Annex 3

Details and Steps for Approval to Invest by Offshore Funds

X: Date of Application given to the DOI for Foreign Investment Approval. The timeline is only indicative.

Step	Particular	Relevant Laws	Timeline (upto)	Government Fee
One	<i>Obtaining approval from DOI/IPB for foreign investment</i>	<i>FITTA 1992</i>	<i>x+ 75 days</i>	<i>Deposit of up to Rs. 20,000, refundable</i>
Two	<i>Obtaining approval from NRB for foreign investment</i>	<i>FERA 1962</i>	<i>x+90 days</i>	<i>Not applicable</i>

Annex 4

Documentation Requirement in obtaining Foreign Investment Approval from NRB

Loan Investment	Equity Investment
<ul style="list-style-type: none">• Approval Document from Department of Industry (or Industrial Promotion Board or Investment Board)• Copy of Loan Agreement between Borrower and Lender• Commitment letter assuring that the inflow of Loan Investment in Nepal will be through Banking Channel.• Copy of Board Decision of Lender Company.• Letter of Consent from the concerned regulatory of the lender in lender's home jurisdiction.• Tax Clearance Certificate, Updated Details of Tax Payment and Incorporation Document of the Borrower, if any.• Document evidencing that the Borrower is not blacklisted by Credit Information Centre Limited.	<ul style="list-style-type: none">• Approval Document From Department of Industry (or Industrial Promotion board or Investment Board)• Copy of Board Decision of Investee Company.• Tax Clearance Certificate, Updated Details of Tax Payment and Incorporation Document of the Borrower, if any.• Document evidencing that the Investee is not blacklisted by Credit Information Centre Limited.• Audited Financial Statement of the Investee Company.• Commitment Letter from Investor assuring that the amount invested will not be repatriated within 1 year from the period date of investment.• Document evidencing the source of income and Time-Schedule.
<p><i>Note: As per NRB's policy on external commercial borrowing, the annual interest on the loan should be within (prevailing libor rate for year + premium interest). In case where the lenders are the organization like, IFC, ADB, World Bank, the interest rate shall not exceed (prevailing LIBOR rate + 5.5%).</i></p>	

Annex 5

Details and Steps of Registration of the onshore fund with foreign investment

X: Date of Application given to the DoI for Foreign Investment Approval

<i>Step</i>	<i>Particular</i>	<i>Relevant Laws</i>	<i>Timeline (upto)</i>	<i>Government Fee</i>
One	<i>Obtaining approval from for foreign investment</i>	<i>FITTA, 1992</i>	<i>x+ 75 days</i>	<i>Deposit of up to Rs. 20,000, refundable</i>
Two	<i>Obtaining approval from NRB for foreign investment</i>	<i>FERA, 1962</i>	<i>x+90 days</i>	<i>Not applicable</i>
Three	<i>Registering the Company with the Office of the Company Registrar (OCR)</i>	<i>Companies Act, 2006</i>	<i>x+97 days</i>	<i>As per the authorized capital³³</i>
Four	<i>Registering as an industry with DOI</i>	<i>Industrial Enterprise Act, 1992</i>	<i>x+104 days</i>	<i>Not applicable</i>
Five	<i>Tax Registration (Permanent Account Number) with Inland Revenue Office</i>	<i>ITA, 2002</i>	<i>x+105 days</i>	<i>Not applicable</i>

³³ For example; if the amount of authorized capital is from NRs. 50,00,001 to NRs. 1,00,00,000, registration fees of NRs. 12,000 is applicable, for authorized capital above NRs. 1,00,00,000 registration fee of NRs.2.00 for every NRs. 100,000 of the authorized capital is applicable.

Annex 6

Securities:

As per Company Act:

- Section 2 (x) of the Companies Act defines “Securities” to mean as any Shares, bonds, debentures or stocks issued by a company, and this term includes the receipt relating to deposits of securities and the rights and entitlement relating to securities.
- Section 2 (o) of the Companies Act defines “Preference Share” to mean as a Share issued as a preference share pursuant to this Act
- Section 2 (p) of the Companies Act defines “OrdinaryShare” to mean as a Share other than a preference share.
- Section 2 (s) of the Companies Act defines “Debenture” to mean as any bond issued by accompany whether putting its assets as collateral or not

As per Securities Registration and Issue Regulations, 2008:

- Section 2 (c) of the Securities Registration and Issue Regulation defines “Securities” to mean as shares, stocks, bonds, debentures or debenture stocks issued by the body corporate or certificates related to collective investment schemes or loan certificates, saving certificates or bonds issued by the government or that issued by the body corporate under the guarantee of the government and this word shall also mean other securities designated by the Board to be tradable or transferable though Stock Exchange or the rights and entitlements relating to the securities.

As per Foreign Exchange Regulation Act, 1962:

- Section 2 (g1) of the Foreign Exchange Regulation Act defines “Foreign Investment” to mean as investment in any firm, company or organization in the form of *shares, deposit, earnings from above two (reinvested) and loan/loan facilities* by foreign investor.
- Section 2 (d) of the Foreign Exchange Regulation Act defines “Foreign exchange” to mean as foreign currency, and deposits, loans, borrowings, foreign securities, and instruments like cheque, draft, travelers cheque, credit card, etc which are cleared with foreign currency, and other instruments as published by NRB
- Section 2 (d1) of the Foreign Exchange Regulation Act defines “Foreign Exchange Transaction” to mean as act of buying/selling forex, giving/taking loans or other methods where forex is taken/given
- For foreign exchange transaction (even deposits, loans), foreign investors *need to get approval from NRB and use the exchange rate given by the NRB for the transactions.*

Annex 7

Documents required to be submitted to DOI for Foreign Equity Investment in New Industry

- Project Report 2 copies
- Joint Venture Agreement (JVA), in case of more than one investor 2 copies
- Citizenship certificate of local party or Certificate of Incorporation including Memorandum of Association and Articles of Association, if local party is a company 1 copy
- Copy of passport of foreign party/or Certificate of incorporation, including Memorandum of Association and Articles of Association, if participant is a company 1 copy
- Bio-data / Company profile of the foreign party 1 copy
- Financial Credibility Certificate (FCC) of the Foreign Investor provided by a home country bank or domiciled country bank 1 copy
- Authority letter from the concerned companies or individuals to carry out any necessary work on their behalf, if applicable

Annex 8

Share transfer from an existing shareholder to a foreign investor

To get approval from DOI in Foreign Investment in an Existing Industry by Share transfer, the following document will be required.

- Request from the share transferor
- Request from the share transferee
- Share Transfer agreement
- Copy of minute of the Board meeting of Nepalese company regarding inclusion of foreign investor into the company
- Copy of minute of Board meeting, certificate of incorporation and company profile of the foreign party if the participant is a company.
- Copy of passport and Bio-date of foreign party, if participant is an individual
- Financial credibility certificate of the Foreign Investor provided by a bank.
- Current Shareholders' list as certified by the Company Registrar's office
- Audit Report
- Tax clearance certificate
- Authority letter from the company concerned to sign on behalf of the companies

Share transfer from reserved shares or by increasing the issued capital of the company to a foreign investor:

The industry is required to apply to the DOI on a prescribed application form with the following documents (in addition to above mentioned documents).

- a) Request letter from share transferor
- b) Request letter from share transferee

Note: At the time of approval the share transferor shall be present in person at the DOI. If the industry is not operational as of the date of application, the application should be accompanied with the Project Report too.

Annex 9

The documents required to be submitted to DOI for approval of loan investment.

- Loan Agreement 2 copies
- Certificate of Incorporation, including Memorandum of Association and Articles of Association of the lending agency 1 copy
- Company profile of the lending agency 1 copy
- Industry Registration Certificate 1 copy
- Copy of the minute of the Board of the recipient company regarding the loan to be acquired 1 copy
- Authority letter from the concerned companies or individuals to carry out any necessary work on their behalf, if applicable.

However, it must mention, inter-alia, the interest rate and payment schedule of the principal amount.

Annex 10

IPO Process in Nepal : Procedure:

1. Issuing company going public approaches merchant banks

Issuing company approaches the merchant banks, licensed to provide public issue services as per Merchant Banker Regulations, 2008. Merchant banks submit written proposal accompanied by tentative budget of the issue management process. After the terms and conditions are met, issuing company appoints an issue manager and a formal agreement is signed.

2. Registration of securities

A company incorporated as a public limited company to offer securities to public has to register its securities to Securities Board of Nepal. For the purpose the company has to make an application to the SEBON in a prescribed format given in Schedule 1 of Securities registration and Issue Regulation, 2008 along with the cash receipt voucher charged as securities registration fee. SEBON would issue a securities registration certificate as part of approval of registration of securities.

3. Preparation of prospectus

Upon signing of the agreement, issue manager acts on behalf of the issuing company and drafts a prospectus in a format specified by the Securities Registration and Issue Regulations, 2008.

4. Agreement with the underwriters

Fifty percent of every issue has to be mandatorily underwritten by a qualified underwriter or group of underwriters. After the approval of underwriters list, a separate MOU is to be made and signed by the issue manager on behalf of issuing company with the individual underwriters underwriting the securities issued.

5. Obtain letter from Stock Exchange Ltd.

The issuing company via issue manager should submit one set of documents (prospectus and other documents being registered in SEBON) to Stock Exchange Ltd. to obtain its letter stating that the securities to be issued is qualified to be listed in Stock Exchange as per prevalent listing bylaws. The stock exchange is required to submit its rebuttal against the proposed issue to the board within seven working days from the submission of documents if any in reference to existing exchange by laws. If no such response is received by the board within the stipulated time, board assumes the consent of Stock Exchange to list the securities being offered to the public from the applied prospectus.

6. Registering Prospectus with SEBON

After preparing the prospectus, the prospectus with the required documents and fees need to be registered in the SEBON for the consent and registration. The prospectus registered needs to be signed by all the board of directors implying their responsibility as matters written in the prospectus to be true.

7. Finalizing the approval of issue

Issue managers should update any changes as directed by SEBON in the prospectus. Upon completion of all the disclosure needed as per the Securities Registration and Issue Regulations, 2008, the SEBON grants the registration of prospectus and approval to issue the shares based on the information provided in the prospectus. After receiving registration letter from the SEBON, issue manager should get the prospectus registered with the company registrar's office and if the company has a separate regulatory authority, get the prospectus registered with the same as well. All registration has to be completed before the orientations of the intermediaries and publicity to the public are carried out.

8. Orientation of intermediaries

The issue manager/s in the mean time should appoint bankers to the issue and the collection centers. Issue manager should make sure that intermediaries selected for the issue process know the job assigned to them. For this, issue manager might require to prepare and give proper guidelines to them. In short issue manager should make sure that they work as directed by the issue manager.

9. Finalizing the date of issue opening

The issue manager should communicate the approval of prospectus to the issuing company and the Issuing Company should decide on the date on which they wish to open the public offerings process and inform the same to the issue manager.

According to Securities Issue Guidelines 2008, the issue has to be publicly sold within two months from the date of receiving approval from SEBON.

10. Publishing announcement letter

After all the provisions have been made, issue manager willing to publish offer document or prospectus has to publish announcement in the format prescribed by Securities Registration and Issue Regulations, 2008 Schedule-12 in at least one daily newspaper minimum one week prior to the opening of the issue and the board has to be informed regarding it.

11. Opening of the Issue

The issue has to be opened for at least five working days from the date of opening. Issue can be opened for only four days if the issuing company has at least a total of ten collection centers in five development regions

12. Share Allotment

Under former Securities Allotment Guidelines, 2051, more weight was given to small applicants. However, the new directive (Share Allotment Directive, 2068) has made provisions to allot shares under proportionate basis to ensure equal weight to all applicants irrespective of amount of application or volume of oversubscription. The change in the allotment guideline will encourage application by institutional investors or high net worth individual for large number of shares in one name. Such investors were largely discouraged under previous allotment model where applicants applying for large number of shares were used to be allotted relatively less number of shares. After the change in the allotment guidelines, Janata Bank is the first major IPO in the country.

Under the current allotment guideline, Investors applying for shares less than NRs. 50,000 are categorized as retail investors, and 40% of the issued securities have to be mandatorily allocated for them. Remaining 60% are to be allotted under pro rata basis of allotment. However, if total applications by the retail investors represent more than 40% of total applications receive, all shares will be allotted proportionately.

13. Refund of non allotted share application money

According to Securities Issue Guidelines 2065, Issue manager should start the process of distributing allotment slips and refunding within five days of allocation of shares.

14. Distribution of Share Certificate

As per Section 33 of The Company's Act 2063 the share certificate has to be issued to the share holders within two months from the date of allotment of shares

15. Listing of shares with Nepal Stock Exchange Ltd.

The issuing company should apply for the listing of the issued securities with the stock exchange through an application within thirty days from the date of allotment of shares. The shares can be traded only after the application is approved by NEPSE, which might require further time. Securities could be traded in the secondary market only after seven days after the listing of securities in NEPSE.