



Consultation paper for amendments to the SEBI (Infrastructure Investment Trusts) Regulations, 2014

A. Background:

- 1) SEBI (Infrastructure Investment Trusts) Regulations, 2014 (InvIT regulations) were notified on 26th September, 2014, thereby providing a regulatory framework for registration and regulation of InvITs in India. The regulations, inter alia, prescribe conditions for making a public offer and private placement, initial and continuous disclosures, investment conditions, unit-holder approval requirements, related party disclosures, etc.
- 2) Pursuant to the notification of InvIT regulations, representations and suggestions were received from various market participants for making changes to the said regulations. Based on the recommendations received, a consultation paper proposing amendments to InvIT regulations was issued seeking public comments on August 20, 2015. The aforesaid paper dealt with certain issues which have been taken up again in this consultation paper to insert certain additional conditions, based on feedback received from all stakeholders viz. government, market participants, industry associations, regulatory bodies, etc.
- 3) Apart from the above, based on the feedback received from the aforesaid stakeholders, the paper also proposes certain other amendments.

B. The issues and the proposals for amendment are as under:

- I. **Removing the restriction on the SPV (only in case of such SPV being a Holding Company) to invest in other SPVs holding the assets.**
 - a) **Current regulatory requirement:** Regulation 2(1)(zy) of InvIT Regulations, inter alia states that a SPV is a company or LLP, which holds not less than ninety per cent of its assets directly in infrastructure projects and does not invest in other SPVs.
 - b) **Request for change:** It has been represented that infrastructure assets in India are usually held through different Special Purpose Vehicles (SPVs), where the promoters of such SPVs create separate holding companies (HoldCo) which in turn hold stake in the multiple SPVs which have infrastructure projects under them. Thus, it has been

requested that InvITs be allowed to invest in infrastructure projects through such SPVs (HoldCo) which hold stake in other SPVs having infrastructure assets.

The rationale for necessitating such change are as under:

- i. In Infrastructure sector, specifically for PPP projects, certain concession agreements do not allow for direct change in control in SPVs which holds the assets, thereby making it possible to transfer shares at holding company level only.
- ii. Certain contracts, for example, power purchase agreements in power sector require consents for direct change of control which may be time consuming and not efficient.
- iii. A large proportion of the infrastructure projects in India are financed by Indian financial institutions on a project finance basis where lenders require a pledge on the shares of the SPV. In such cases, if the SPV is held directly by the InvIT, the lenders would seek pledge of the SPV shares held by the InvIT. This might not be attractive for the InvIT investors.
- iv. There are also concerns of tax inefficiencies, lender considerations, difficulties in exit for financial investors, etc. if investment in the HoldCo is not allowed.

Further, feedback has also been received that removing the restriction of SPV to invest in other SPVs may not be advisable because of the following concerns:

- i. Listing of units of InvITs is mandatory, thus reasonable exit option is already available under the current regulation. Also having a HoldCo does not improvise the exit option for a unit-holder.
- ii. In the event of an infrastructure project failing or leading to losses, such additional layers will only make it difficult to identify the ultimate beneficiary who should bear/indemnify the losses.
- iii. A multi layered structure increases governance and compliance risk for the Trustee, which further requires more oversight. Also, such oversight and monitoring will become extremely difficult as one HoldCo would hold controlling interest in many SPVs each of which, in turn, holds projects, making the structure more complex and difficult to monitor.



The government in the Union Budget 2016-17, has provided that the SPV distributing dividend to the business trust will be exempt from paying DDT. Provided the business trust holds 100% of the SPV or holds all of the share capital (unless otherwise) by direction of any Government/ requirement of any law / where such SPV is held by Government or Government bodies.) Further, the dividend income is exempt in the hands of the business trust. Also, the dividend component of the income distributed by the business trust is exempt in the hands of the unit holders.

Hence, in view of the above, if the structure is changed from the single layer SPV to the multiple layer, then there would be tax implications.

c) Proposals: In view of the feedbacks received from the market participants, the following options are proposed:

Option I: To retain the existing provision i.e single layer SPV or;

Option II: To amend regulation 2(1)(zy) and other related regulations for allowing investments by InvIT in two level SPV structure i.e. removing the restriction on the SPV to invest in other SPVs, and thereby allowing InvIT to invest in a Holding Company (HoldCo) which subsequently holds stake in SPV(s), subject to following conditions:

- i. No other shareholder or partner of the underlying SPV(s) shall have any rights that prevent the InvIT and HoldCo from complying with the provisions of these regulations;
- ii. The investment manager, in consultation with the Trustee, shall ensure that atleast one authorized representative of the HoldCo or the InvIT is appointed on the Board of directors or governing board of the underlying SPV(s);
- iii. The investment manager shall ensure that in every meeting including annual general meeting of the underlying SPV(s), the HoldCo participates in the voting process.
- iv. All requirements related to the related party transactions, etc. shall also be applicable at the underlying SPV level in addition to the HoldCo, as may be specified by SEBI.



- v. All responsibilities of the investment manager with respect to the SPVs shall apply at both the levels.
- vi. All investment conditions and leverage requirements will apply at the consolidated level.
- vii. The requirement of mandatory distribution of at least 90% of the net distributable cash flows shall apply to the underlying SPVs. Further, 100% of the net distributable cash flows of the HoldCo shall be distributed.
- viii. All financial statements of the InvIT shall be consolidated with both the SPVs.
- ix. The HoldCo shall not be engaged in any other activity other than holding of the underlying SPV(s).
- x. Any other conditions as SEBI may deem necessary.

II. Mandatory sponsor holding in InvIT

- a) **Current regulatory requirement:** Regulation 12(3) of the InvIT regulations requires the sponsor(s) of the InvIT to hold, on a collective basis, not less than twenty five per cent of the total units of the InvIT on a post-issue basis for a period of not less than 3 years from the date of the listing of such units.
- b) **Need for change:** It has been represented that the road assets in India are operated under a separate concession with NHAI or the state. There is a separate SPV for each concession. The project lender(s) typically fund up to 80% of the project cost in the SPV's while the balance 20% is the sponsor's equity contribution in the SPV. InvITs are considered to be investment vehicles, for providing stable cash flows to the investors. The distributable cash flow received by the InvIT, in the form of dividends from assets and servicing of debt instruments subscribed by the InvIT in the assets, are utilized towards meeting the yield requirements of investors.

InvIT investors would typically include institutional investors like insurance companies, pension funds, mutual funds, etc. looking for a stable and predictable yield. Thus, a capital structure with no or low leverage would ensure that the amount



of interest which would have otherwise been paid to lenders is available for payment of yield to investors.

For such cash flows to be made available to the investors at InvIT level, a significant portion of the existing debt of the SPV has to be retired. In a scenario where a substantial portion of the existing debt at the assets is replaced through primary issuance at InvIT, the value of the InvIT units on a post-issue basis would reflect a value equivalent to the sum of the market value of the equity capital of the assets and the retired debt at the assets.

Thus, the requirement for sponsor to hold 25% of units at InvIT on a post-issue basis, may limit the monetization for sponsors, reduce release of capital for such sponsors and may also not be feasible for the existing set of sponsors. Further, in certain circumstances this may lead to sponsor putting money, out of its own pocket, in the InvIT so as to maintain the required 25% stake. Thus depriving the sponsor of the opportunity to monetize the asset and be able to infuse capital into new infrastructure projects.

- c) **Proposals:** In view of the representations received from market participants, it is proposed to provide options to sponsor(s) to continue with the existing criteria i.e. sponsor to hold not less than twenty five per cent of the total units of the InvIT after initial offer of units, on a post-issue basis for a period of not less than 3 years from the date of the listing of such units or sponsor would be provided with one of the following options:-

Option 1: Sponsor(s) of the InvIT would hold not less than 10% of the total units of the InvIT on a post-issue basis subject to following conditions:

- i. 10% of the total units of the InvIT held by the sponsor(s) on a post-issue basis shall be locked in for a period of atleast 3 years from the date of the listing of such units.
- ii. Any holding by the sponsor(s) exceeding 10%, on a post issue basis, would be locked in for a period of 1 year from the date of the listing of such units.
- iii. Sponsor(s) would additionally be made responsible for all acts, omissions and representations/ covenants of the InvIT related to formation of InvIT, sale/

- iv. transfer of assets/ SPV to the InvIT and operations of the InvIT carried out by Project Manager and Investment Manager.
- v. The InvIT/ the Trustee shall have first recourse against the Sponsor and its associates for any breach in this regard.
- vi. Project Manager of the InvIT shall be the sponsor or an associate of the sponsor and shall continue to act in such capacity during the life cycle of the InvIT unless suitable replacement is appointed by the unit-holders through the Trustee.
- vii. Other procedural requirements as deemed necessary by SEBI.

Option 2: The sponsor would divest upto 85% subject to the terms of the concession agreement under following arrangements:

- i. Sponsor would retain current equity for the first year (with given condition that the sponsor must hold a minimum of 15% of the units of InvIT on post issue basis)
- ii. After the first year, the sponsor would be allowed to dilute the equity upto the minimum recommended floor of 15% (with stipulation as given in option 1 (iv) above) and hold 15% equity during the year 2&3.

III. Increase the number of sponsors from 3 to 5

- a) **Current regulatory requirement:** Regulation 4(2)(d)(i) and 12(3) of InvIT regulations mandates that the InvIT can have maximum of 3 sponsors, which shall collectively hold 25% of the units of InvIT on post issue basis.
- b) **Need for change:** It has been represented that there are various cases in which a number of group companies/associates of the sponsor, are stakeholder in the SPVs executing the project. Therefore, capping the number of sponsors at three may prove restrictive. However, it has also been out pointed out that the parallel dilution i.e. as suggested in paragraph II above would tantamount to reduction in minimum sponsor holding.



- c) **Proposal:** In order to address the contradictory opinions in the matter, the following is proposed

It is proposed that in proposal at paragraph II above, the consultation paper suggests two options i.e. the existing criteria or the sponsor holding 10% or divesting 85% subject to the compliance with conditions as has been laid out in paragraph II above. In view of the same, following is proposed:

- a. If the sponsor holds not less than 25% of the total units of the InvIT after initial offer of units, on a post-issue basis for a period of not less than 3 years from the date of the listing, then the number of sponsors may be increased from 3 to 5.
- b. However if the sponsor (s) chooses not to hold 25% of the total units of the InvIT after initial offer of units, on a post-issue basis (i.e. either of the options finalized at para II above) then the maximum number of sponsors shall remain at 3.

IV. Approval of related party transactions by the unit holders

a) Current regulatory requirement:

- i. Regulation 22(3) and 22(4) of the InvIT regulations requires the approval of 60% of the unit holders, apart from related parties, for passing related party transactions that are procedural in nature.
- ii. Regulation 22(5) requires approval of 75% of the unit holders, apart from related parties, for passing of special resolutions such as change in investment manager, investment strategy, delisting of units, etc.

- b) **Need for change:** Representations have been received that the requirement of 60% and 75% of investor approval may not be feasible, especially when related parties have to abstain from voting. Further, it has been represented that the requirement of unit holder approval, in case of related party transactions (RPTs) should be in line with the approval requirement under the Companies Act, 2013.

- c) **Proposal:** Section 188 of the Companies Act, 2013 lists out the related party transactions which require approval from the board of directors and/or the shareholders. The section inter-alia states that if such RPTs meet the prescribed

thresholds then approval is required from the shareholders by way of passing of an ordinary resolution. The section also requires that the directors who are related to the transaction under discussion, in the meeting, shall not be present at the meeting during the discussion and the directors who are related parties to such contract or agreement cannot vote for the same. Given the nature of the InvIT, a complete alignment with the Companies Act cannot be made. It has been indicated that it would not be possible to achieve the current level of thresholds as prescribed in the InvIT regulations. Accordingly, the following thresholds are proposed:

- i. For the purpose of regulation 22(3) and 22(4), the matter shall be approved if the votes cast by the unit holders in favor of the proposal shall be more than the number of votes cast by the unit holders against it.
- ii. For the purpose of regulation 22(5), the matter shall be approved if the votes cast by the unit holders in favor of the proposal shall be at least one and half times more than the number of votes cast by the unit holders against it.
- iii. Further, in both the above cases, the voting by any person, who is a related party in such transaction, as well as associates of such person(s) shall not be taken into account.

V. Aligning minimum public holding requirement with SCRR

- a) **Current regulatory requirement:** Regulation 14(4)(d) and 16(6) of InvIT regulations, inter-alia requires that the units proposed to be offered to the public shall not be less than twenty five per cent of the total outstanding units. Further, the minimum public holding for the units of the publicly offered InvIT after listing shall be 25% of the total number of outstanding units, at all times, failing which action may be taken as may be specified by the Board and by the designated stock exchanges including delisting of units.
- b) **Need for change:** Infrastructure assets are usually large and the value of InvIT in which such assets are parked would be very high. Therefore, for an issuer to market and sell an issue size of 25% of the value of such huge InvITs may not be plausible as the product is new and the market may not have the appetite for such big issues.
- c) **Proposal:** A proposal has been received to align the same with the requirements as under Securities Contracts (Regulation) Rules, 1957 (SCRR). Therefore the requirement of minimum offer to public and minimum public holding, of the outstanding units, shall

be linked with the requirement of public offer of 25%/10%, as specified under Rule 19(2)(b) and 19A of the Securities Contracts (Regulation) Rules, 1957.

VI. Eligibility Criteria for Investment Manager:

- a) **Current regulatory requirement:** Regulation 4(2)(e)(ii) of the InvIT regulations requires the investment manager to have not less than five years experience in fund management or advisory services or development in the infrastructure sector.
- b) **Need for Change:** It has been represented that for each InvIT, an investment manager will need to be incorporated. While the key managerial personnel of investment manager and sponsor will have domain expertise, the investment manager may be a newly incorporated company and may not be able to meet the five year experience criteria. It has been suggested that if the investment manager is promoted by a sponsor who has prior experience then the investment manager may be exempted from the requirement of having at least 5 years prior experience.
- c) **Proposal :** Those Investment Managers, which do not have at least 5 years prior experience, would be allowed subject to the condition that sponsors have at least 5 years of experience in fund management or advisory services or development in the infrastructure sector (similar to what has been allowed for sponsor) subject to the condition that sponsor is an associate of investment manager. The other conditions as prescribed in regulation 4(2)(e) shall remain unchanged.

VII. Responsibilities of the Trustee and its associate :

- a) **Current regulatory requirement :** Regulation 2(zv) of the InvIT regulations provides that "related parties" of InvIT shall include: (i) parties to the InvIT; (ii) any unit holder holding, more than 20% of the units of the InvIT; (iii) associates, promoters, directors, and partners of the persons mentioned in (i) and (ii). Regulation 9(19) of the InvIT regulations provides that the Trustee or its associates shall not invest in units of the InvIT in which it is designated as Trustee. Also, schedule III-13(c) and Schedule IV-(17) of the InvIT regulations requires brief description of the material litigations and regulatory actions, whether completed or pending, against the InvIT, sponsor(s), Investment Manager, Trustee, or any of their associates, if any in the last 5 years.



- b) **Need for change:** It has been represented that the Trustee is an independent entity, which is a Debenture Trustee registered with SEBI. Further, the Trustee does not have any financial interest in the InvIT, except the fee for its services as a Trustee. Also the assets of the InvIT are independent of the assets and liabilities of the Trustee company and are even protected against insolvency of the Trustee. Hence, disclosure of associates of Trustee is not material for any investors in the InvIT. Therefore certain disclosures need not extend to Trustee.
- c) **Proposal :** In view of the above, the following changes may be made to the InvIT regulations:
- i. Associates of the Trustees would not form a part of the parties to the InvIT.
 - ii. Associates of Trustees would be allowed to invest in units of the InvIT in which it is designated as Trustee, subject to such transactions being conducted at an arm's length basis.
 - iii. The disclosure of litigations of associates of Trustee as per Schedule III and Schedule IV of the InvIT regulations, may not be required.

VIII. **Allowing InvIT to lend to the underlying SPVs**

- a) **Current regulatory requirement:** Regulation 18(10) of the InvIT regulations doesn't allow the InvIT to undertake lending to any person.
- b) **Need for change:** It has been represented that since infrastructure projects have long gestation period and are normally financed by a mix of equity and debt (loan) from the financial institutions, hence, in case of transfer of such assets from sponsor to an InvIT, such transaction may require financing/ retiring the debt (loan) of such projects.
- c) **Proposal:** InvIT regulations may be amended to allow lending. However, the same may be restricted to only the SPVs in which the InvIT has invested, subject to other conditions as deemed necessary.

IX. **Operational aspects**

i. **Filing of Project Management Agreement at the time of filing the offer document**

SEBI has received representations that as the infrastructure assets identified at the time of registration of InvIT may change at the time of filing of offer document. Therefore, entering

into the Project Implementation Agreement at the time of application for registration may not be feasible.

Proposal: Accordingly, the InvIT regulations may be amended to clarify that only Project Management Agreement may be required to be filed at the time of filing of offer document with SEBI.

ii. Liability of the unit holders:

As per the InvIT regulations, the liability of the unit holders is limited to the extent of the units held by them. However, SEBI has received representations that in the InvIT regulations there is no explicit provision with respect to liability of unit holders and hence, more clarity may be provided before entities such as insurance companies, (who invest on behalf of their investors), are allowed to invest in InvITs.

Proposal: It is proposed to clarify that the unit-holder is an investor and his rights and obligations are limited to the amount of his investment in the units of InvITs.

C. Public Comments:

- i. In light of the above, public comments are invited on the proposals contained in the consultation paper. Comments/ suggestions may be provided in the format given below:

Name of entity / person / intermediary/ Organization			
Sr. No.	Pertains to Point No.	Suggestions	Rationale

- ii. Further, comments may also be forwarded by email to invit@sebi.gov.in or may be sent by post to the following address latest by June 28, 2016.

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