



CAPITAL MARKETS

N. A. SHAH **BULLETIN**

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EXECUTIVE SUMMARY

- Further amendments to the Foreign Portfolio Investor (FPI) regulations have been made.
- SEBI has changed the Know your Customer (KYC) requirements for FPIs.
- SEBI has introduced guidelines for Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) to issue debt securities.
- Further amendments have been made to REIT and InvIT regulations.
- SEBI has issued an informal guidance on SEBI (Substantial Acquisition of Shares and Takeovers) Regulations (SAST Regulations) with regards to indirect acquisitions.

1. Amendment to FPI Regulations

SEBI has amended the SEBI (Foreign Portfolio Investor) Regulations, 2014. The key amendments are summarised as under:

Topic	Extant Provision	Revised Provision
Eligibility Criteria of Foreign Portfolio Investor (FPI)	<p>Applicant must be resident of a country whose security market regulator is signatory to:</p> <ul style="list-style-type: none"> i. International Organization of Securities Commission’s Multilateral Memorandum of Understanding (Appendix A signatories) ii. bilateral MoU with SEBI. 	<p>Now, any resident of a country approved by the Indian Government is also eligible to be a FPI.</p>
	<p>Additional Conditions for eligibility:</p> <ul style="list-style-type: none"> i. the applicant is legally permitted to invest in securities outside the country of its incorporation; ii. the applicant is authorized by its Articles or equivalent document(s) or the agreement to invest on its own behalf or on behalf of its clients; iii. the applicant has sufficient experience, good track record, is professionally competent, financially sound and has a generally good reputation of fairness and integrity; iv. the grant of certificate to the applicant is in the interest of the development of the securities market; 	<p>Category I and Category II foreign portfolio investor are not required to comply the mentioned additional conditions.</p>

<p>Definition of Category II FPI</p>	<p>Includes mutual funds, investment trusts, and insurance reinsurance companies; appropriately regulated banks, asset management companies, investment managers, portfolio managers; broad based funds whose investment manager is appropriately regulated; university funds and pension funds; university related endowments already registered with SEBI.</p>	<p>The definition shall now include: i. broker dealers ii. swap dealers.</p>
<p>Definition of Broad Based Fund</p>	<p>Broad based fund means fund established outside India having at least 20 investors, with no investor holding more than 49% of the fund. Institutional investor who holds more than 49% of the broad based fund must itself be a broad based fund.</p>	<p>Exception in case the institutional investor is a Bank, Sovereign Wealth Fund, Insurance company, Reinsurance company, a Pension Fund, then the applicant fund is deemed to be a broad based fund if such institutional investor(s) shall, jointly or separately, hold more than fifty percent of the fund at all times.</p>
<p>Loss of Category II status for broad based fund</p>		<p>On exit of some investors, broad based fund shall find new investors within a period of 90 days or else it shall lose Category II status.</p>
<p>FPIs to provide additional information to ensure compliance with Prevention of Money Laundering</p>	<p>FPIs are required to provide any additional information or documents required by the designated depository participant to ensure compliance with the PMLA, FATF and circulars issued from time to time by SEBI.</p>	<p>FPIs to further provide, beneficiary ownership details of their clients as discussed in depth in Para 2 of this newsletter.</p>

Act (PMLA) and Financial Action Task Force standard (FATF)		
Responsibility of designated depository participants	Designated depository participant is to ensure the equity held by FPIs are free from all encumbrances.	It is further explained that encumbrances created to meet statutory or regulatory requirements is not to be considered.

2. KYC Requirements for FPIs

It has been reiterated that neither the Non Resident Indian (NIR) / Person of Indian Origin (PIO) nor Overseas Citizen of India (OCI) can be Beneficial Owner of FPIs. They can however be promoters of non-investing entity which wishes to have Category II Investment manager of other FPIs. Accordingly, SEBI has tightened the KYC rules and requirements.

It may be noted that "Beneficial owner" has to be interpreted as under:

BO would be a natural person or persons, who, whether acting alone or acting together, have controlling ownership interest in the FPI or control over the FPI and if a BO cannot be identified in this manner, the senior managing official of the FPI would be construed to be its BO.

SEBI has emphasized that *Look through principle* shall be applied for identifying BO so that Real owners/ effective controllers are identified. If FPI is a company or Trust and is represented in India by its service providers, it should provide information of the persons that effectively own or control the FPI. Also, if control is exercised through means such as voting rights, agreements, arrangements etc., it should be specified.

The BO in case of FPI will be determined as follows:

FPI is a company	The beneficial owner is the natural person(s), who, whether acting alone or together, or through one or more juridical person, has a controlling ownership
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	<p>interest or who exercises control through other means. For the purpose of this definition;</p> <ul style="list-style-type: none"> • Controlling ownership interest means ownership of or entitlement to more than 25% of shares or capital or profits of the company; • Control shall include the right to appoint majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements;
FPI is a partnership firm	The beneficial owner is the natural person(s) who, whether acting alone or together, or through one or more juridical person, has ownership of/entitlement to more than 15% of capital or profits of the partnership
FPI is a unincorporated association or body of individuals	The beneficial owner is the natural person(s), who, whether acting alone or together, or through one or more juridical person, has ownership of or entitlement to more than 15% of the property or capital or profits of such association or body of individuals
FPI is a Trust	The identification of beneficial owner(s) shall include identification of the author of the Trust, the trustee, the beneficiaries with 15% or more interest in the Trust and any other natural person exercising ultimate effective control over the Trust through a chain of control or ownership
FPI based in high risk jurisdiction	If the FPI is based in high risk jurisdiction, a lower materiality threshold of 10% is to be applied to identified BO instead of 25% / 15% mentioned above

SEBI however has given time till 10th October 2018 to either regularize the FPI structure or close their existing position in Indian securities market. It also mandated that existing structures which were not compliant should not create any fresh position after the end of expiry of derivative contract of April 2018. One of the impact of the circular will be in area where there are more than one

FPIs having common BOs and whose aggregate equity holding in India exceeds 10%.

3. Guidelines for issue of debt securities by REITs and InvIT

The REIT and InvIT regulations now allow REITs and InvITs to issue debt securities. SEBI has issued guidelines for the same. The salient points of the guidelines are as follows:

- a. REITs/ InvITs shall follow the SEBI (Issue and Listing of Debt Securities Regulations), 2008 (ILDS Regulations) subject to certain exceptions. The compliances required to be made by ILDS regulations such as filing of offer document with the registrar of companies, appointment of debenture trustees, etc. with respect to Companies Act and Registrar of Companies shall not apply to REITs/ InvITs.
- b. The REIT/ InvIT shall appoint registered debenture trustees, as per SEBI (Debenture Trustees) Regulations. Provided, a trustee to the REIT/ InvIT cannot be appointed as a debenture trustee to an issue of such debt securities.
- c. Such securities shall be secured by a charge on the assets of REIT/ InvIT or the holding company or the SPV.
- d. REITs/ Invits are required to provide the prescribed disclosures such as asset cover available, debt-equity ratio, debt service coverage ratio, interest service coverage ratio, networth etc. Any deviation in the use of proceeds of the debt issue is required to be reported to the stock exchanges on a half yearly basis.

4. Amendment to the REIT Regulations

SEBI has made the following amendments for REIT regulations:

Topic	Extant Provision	Revised Provision
Definition of holdco	Amongst others, holdco means a company or LLP in which REIT holds or proposes to hold controlling interest and is not less than fifty one percent of the equity which in turn invests	Now, controlling interest is not necessary, and the equity should be not less than fifty percent

	in other SPVs that ultimately hold the properties	
Definition of real estate assets	Means properties owned by REIT whether directly or through a special purpose vehicle	Real estate assets shall now mean properties held by REIT, on a freehold or leasehold basis, whether directly or through a holdco and/ or a special purpose vehicle.
Eligibility criteria pertaining to sponsors	Each sponsor or sponsor group shall be clearly identified in the application for registration, in the offer document.	For entities categorized as sponsor group only the following shall be considered: <ul style="list-style-type: none"> a. Person directly or indirectly interested in any asset, SPV or holdco proposed to be transferred to the REIT b. Person, directly or indirectly holding units of REIT on post issue basis c. Person who has not less than five years' experience in development of real estate or fund management in the real estate industry.
Conditions to invest through holdcos or SPVs		Now, the shareholder/ partnership agreement are required to provide mechanism for resolution of disputes. Further, the REIT regulations shall prevail in

		case of inconsistencies in such agreement.
	The manager in consultation with the trustee shall appoint majority of the board of directors/ governing board of the holdco and/or SPVs	Now, they shall appoint such number of nominees on the board of directors/ governing board which is in proportion to the shareholding/ holding interest of the REIT/ holdco in the SPV
Investment conditions	Not more than 20% of the value of the REIT assets shall be invested in assets like under construction properties, mortgage backed securities etc.	This shall now also include investing in unlisted equity shares of companies deriving at least 75% of their operating income from real estate activity.
	At least 75% of the REIT assets on consolidated basis should be rent generating.	The condition is now has been done away with.
Trustee details for REIT registration		Along with other details of the trustee, now copy of the executed trust deed is also required to be attached.
Offer document disclosures	Brief description of material litigations and regulatory actions pending against the REIT sponsor, manager, or any associate etc. in the past 5 years is to be disclosed in the initial offer document/follow on document.	Now all such disclosures have to be given for all periods.

5. Amendment to the InvIT Regulations

SEBI has made the following amendments for InvIT regulations:

Topic	Extant Provision	Revised Provision
Definitions		Definition of Institutional Investor has been introduced : Institutional investor is defined as a qualified institutional buyer; or family trust or systematically important NBFCs or SEBI registered intermediaries with a net worth of more than 500 crore rupees.
Definition of Project Manager	Project Manager was defined to mean a person	Project Manager is now defined to mean a company or LLP or a body corporate
Definition of sponsor for PPP projects	For PPP projects sponsor shall mean the infrastructure developer or a SPV holding concession agreement	Now, sponsor means any company or LLP or body corporate which sets up the InvIT and is designated as such at the time of making application to SEBI
Responsibilities of the Investment Manager	The investment manager should ensure audit of accounts once a year and submit such audit report within 45 days of end of financial year.	The investment manager can now submit the audit report within 60 days of end of financial year.
Raising funds by way of private placement	The InvIT could raise funds by way of private placement only from qualified institutional buyers and body corporates, subject to certain conditions	The InvIT can now raise funds from institutional investors as defined in the regulations.

		For an InvIT to raise funds by way of private placement is required to file the final placement memorandum with SEBI within a period of ten working days from the date of listing of the issued units.
Raising funds by public issue	Draft offer document filed with SEBI shall be published on website of SEBI, Stock exchanges and merchant bankers associated with the issue.	Now, the draft offer document is to be published on the website of the InvIT as well.
Conditions to invest through holdcos or SPVs	An agreement is to be entered with the other shareholder or partner of the holdco or the SPV before investing, agreeing that, such shareholder or partner cannot have any right to prevent the InvIT from complying with the InvIT regulations.	Now, the shareholder/partnership agreement can provide mechanism for resolution of disputes. Further, the InvIT regulations shall prevail in case of inconsistencies in such agreement.
Trustee details for InvIT registration		Along with other details of the trustee, now copy of the executed trust deed is also required to be attached.
Offer document disclosures	Brief description of material litigations and regulatory actions pending against the InvIT, sponsor, manager, or any associate etc. in the past 5 years is to be disclosed in the initial offer document/follow on document.	Now all such disclosures have to be given for all periods.

6. SEBI Informal Guidance in relation to SAST regulations

Facts:

Listed Company (Target Company) in India has 75% stake held by a foreign promoter entity. The foreign promoter company is held through several layers by the ultimate holding company.

The promoter group is envisaging an internal restructuring exercise for simplification of the holding structure. The internal restructuring shall be undertaken on the same day, in the following manner:

- i. The shares of the third level holding company of the Target Company are transferred within group entities.
- ii. The shares of the second level holding company of the Target Company is transferred on the same day between various group entities.

Later on, the third level holding company is then merged with another company which is a subsidiary of its parent company incorporated outside India.

All levels of holding entities and other relevant group entities except for the Target Company are incorporated outside India.

With regards to the above steps the company requested SEBI for an informal guidance for the following queries:

Query:

- a. Whether transfer of shares of the second and third level holding companies shall result in an indirect acquisition of the Target Company and hence the acquiring entities are required to make an open offer subject to certain exemptions?

SEBI Reply:

Since such entities are indirectly, acquiring more than 25% (75%) of the shares of the target company allowing them to exercise more than 25% of the voting rights, the acquiring entities are required to make an open offer subject to exemptions.

- b. If the conditions required for exemptions are satisfied, will inter se share transfer amongst the holding and subsidiary companies will qualify for exemption from making an open offer?

SEBI Reply:

Yes subject to the conditions.

- c. If the company is exempt from making an open offer, will the entities have to acquire the shares as per the pricing conditions mentioned in proviso to Regulation 10(1)(a)?

SEBI Reply:

The requirements on pricing as per Regulation 10(1)(a) would need to be complied with.

- d. Can a single consolidated filing be made to stock exchanges and to SEBI for multiple transfers of shares of various holding entities made on the same day?

SEBI Reply:

A consolidated filing can be made provided details of all the transfers are provided in the same filing.

- e. Where the third level holding company merges with another group entity in a foreign jurisdiction, will it be considered as an indirect transfer and will it be eligible for exemption from making an open offer?

SEBI Reply:

The merger will be considered as an indirect transfer. For exemption from making an open offer, the scheme of merger has to be pursuant to an order of a Court or competent authority. Since, the transferor entity and transferee entity are foreign entities, the merger is not pursuant to an order of a Court or competent authority as defined under the SEBI regulations. Hence the merger would not be exempted from the obligation to make an open offer.

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