Consultation paper released by SEBI for amendments to SEBI (Infrastructure Investment Trusts) Regulations

August 25, 2015

In brief

The Securities and Exchange Board of India (SEBI) notified the SEBI (Infrastructure Investment Trusts) Regulations (InvIT Regulations) on 26 September 2014. With this, the SEBI provided a regulatory framework for registering and regulating Infrastructure Investment Trusts (InvIT) in India.

The SEBI has received suggestions for making amendments/ providing clarifications with respect to the InvIT Regulations. Based on the suggestions received, SEBI issued a consultation paper on 20 August 2015 on the proposed amendments to the InvIT Regulations and has solicited public comments on this paper which can be provided by 6 September 2015.

The consultation paper deals with following two topics:

1. Allowing InvITs to invest in a two-level special purpose vehicle (SPV) structure;
2. Reducing the sponsor commitment in InvIT from 25 percent to 10 percent.

In detail

In this news alert, PwC provides an overview of the suggested framework and a comparison to the current framework, along with their salient features.

Allowing InvITs to invest in a two-level SPV structure

Current Framework	Proposed Framework
Regulation 2(1)(zy) of the InvIT Regulations currently allows InvITs to hold the infrastructure assets through an SPV in which InvIT holds control.	It is proposed to allow InvITs to invest in a Hold Co that invests in other SPVs (underlying SPVs), subject to the following conditions: 1. InvIT holds controlling interest and not less than 50 percent of equity share capital or interest in the Hold Co.; Hold Co., in turn, holds controlling interest and not less than 50 percent of equity share capital or interest in the underlying SPV; 2. Hold Co. shall not engage in any other activity, other than holding the underlying SPV;

Current Framework	Proposed Framework
	3. Financial statements of the InvIT shall be consolidated with both the SPVs, i.e. the Hold Co. and underlying SPV. 4. All investment conditions and leverage requirements will apply at a consolidated level; 5. Mandatory distribution of at least 90 percent of the distributable cash flows shall apply to the underlying SPVs. 100 percent of the net distributable cash flows of the Hold Co. shall be distributed to the InvIT; 6. The investment manager, in consultation with the trustee, is required to ensure that at least one authorised representative of the Hold Co. or the InvIT is appointed on the Board of directors or governing board of the underlying SPVs; 7. The investment manager is required to ensure that the voting of the Hold Co. is exercised at every meeting of the underlying SPV, including the annual general meeting; 8. All responsibilities of the investment manager with respect to the SPVs shall apply at both levels; 9. All corporate governance norms shall be applicable to the underlying SPVs in addition to the Hold Co.; 10. No other shareholder/ partner of the underlying SPV(s) shall have any rights that prevent the InvIT/ Hold Co. from complying with the provisions of the InvIT Regulations

Rationale for the proposed amendment

The infrastructure assets in India are generally held through different SPVs, where the promoters of such SPVs create separate holding companies.

Also, specifically for Public Private Partnership (PPP) projects, certain concession agreements do not allow for a direct change in the control of the SPV which holds the assets, thereby making it possible to transfer shares at Hold Co. level only. Furthermore, some contracts require consent for a direct change in control, which may be time-consuming and, therefore, not efficient at the time of InvIT listing. There are also concerns with regard to lender considerations, difficulties in exits for financial investors, etc. if the investment in Hold Co. is not allowed.

In light of the above, it is proposed that InvIT be allowed to invest in a Hold Co. which in turn have a stake in the Underlying SPVs.

Relaxing the sponsor commitment in InvIT from 25 percent to 10 percent

The present guidelines require the sponsor of the InvIT to hold, on a collective basis, not less than 25 percent of the total units of the InvIT on a post-issue basis, for a period of not less than three years from the date of listing such units.

It is proposed that the sponsor commitment be reduced from 25 percent to 10 percent, as follows:

1. Sponsor(s) of the InvIT should hold not less than 10 percent of the total units of the InvITs on a post-issue basis;
2. For PPP projects, the consolidated value of sponsor holdings at the SPV level and the value of the units of the InvIT held by the sponsor shall not be less than the value of 10 percent of the total units of the InvIT after initial issue of the units, on a post-issue basis.

Rationale for the proposed amendment

Infrastructure assets are usually financed through debt and hence the capital structure of the SPV is generally debt heavy. As a consequence of this, the value of the sponsor's stake in the total capital structure in such SPVs (equity value) is in minority value. High leverage at the asset level leads to substantial cash flows being utilised towards servicing the existing project finance debt.

For cash flows to be made available to the investors at InvIT level, a significant portion of the existing debt at the asset level has to be retired. In a situation where a substantial portion of the existing debt at the asset level is replaced through primary issuance at InvIT level, the value of 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 level and the retired debt at the asset level.

Given the above, the requirement of the sponsor to hold 25 percent of the units at InvIT level on a post-issue basis may reduce the release of capital for such sponsor and may not be lucrative.

The takeaways

The release of a consultation paper is a clear indication that SEBI is taking consultative approach with the stakeholders, to remove impediments and increase the interest in this sector. By inviting public comments, SEBI intends to have the stakeholders' views in finalising the Regulations.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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