

Regulations enabling Foreign Investment in Investment Vehicles (including AIFs, REITs and InvITs) notified

November 20, 2015

In brief

The Reserve Bank of India (“RBI”) has notified the much-awaited regulations enabling foreign investments under the automatic route in Alternative Investment Funds (“AIF”), Real Estate Investment Trusts (“REIT”), Infrastructure Investment Trusts (“InvIT”) and other entities regulated by the Securities and Exchange Control Board of India (“SEBI”) or any other authority designated for such purpose (collectively referred to as “Investment Vehicles”).

Non-resident Indians (“NRIs”) and Registered Foreign Portfolio Investors (“RFPIs”) are also permitted to invest in units of Investment Vehicles under this route.

Downstream investment by an Investment Vehicle are classified as foreign investment where neither the Sponsor nor Manager nor Investment Manager are Indian-owned and controlled. For this purpose, the extent of foreign investment in the corpus of the Investment Vehicle is irrelevant.

Where the downstream investment is regarded as foreign investment, it will be subject to sectoral caps and conditions/ conditions for Foreign Direct Investment (“FDI”) in Limited Liability Partnerships (“LLP”).

In detail

Backdrop

Attracting long-term foreign capital is believed to be one of the key drivers for India’s economic growth. In this regard, the Government is introducing various policy reforms with respect to foreign investments in the Indian economy.

AIFs, REITs and InvITs are expected to provide impetus to various crucial sectors of the Indian economy. Therefore, foreign investment in these Investment Vehicles has been

on the radar of the Union Government in recent times. This is evident from the following:

- The Hon’ble Finance Minister in his Budget speech in 2015 proposed foreign investments in AIFs.
- On 6 May 2015, the Union Cabinet approved inclusion of REITs as an eligible financial instrument under the exchange control regulations.

- In July 2015, the Union Cabinet cleared a proposal allowing foreign entities to invest in AIFs.

With specific tax regimes being already introduced with respect to each of the above Investment Vehicles, an enabling regulatory framework is seen as the next step in the process for opening up these Investment Vehicles to foreign investors.

The RBI has now notified the much awaited regulatory policy¹ in this regard, which is discussed in detail in the ensuing paragraphs.

¹ By way of amendment to The Foreign Exchange Management (Transfer or Issue of Security by a Person Resident

outside India) (Eleventh Amendment) Regulations, 2015 and Foreign Exchange Management (Permissible

Capital Account Transactions) (Fourth Amendment) Regulations, 2015

Regulatory framework – Investment Vehicles

1. Foreign investment permitted in Investment Vehicles

A person resident outside India [including an RFPI and an NRI] has now been permitted to invest in units of Investment Vehicles.

For this purpose, 'Investment Vehicle' means an entity registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose, and shall include:

- (i) REITs governed by the SEBI (REITs) Regulations, 2014,
- (ii) InvITs governed by the SEBI (InvITs) Regulations, 2014, and
- (iii) AIFs governed by the SEBI (AIFs) Regulations, 2012.

It is to be noted that no specific regulatory approval would be required for the purpose of such investments, subject to satisfaction of the other prescribed conditions.

2. Sale/ transfer/ pledge of units in Investment Vehicles

Such investments can be transferred or sold in any manner or redeemed as per SEBI regulations/ RBI directions.

However, the non-resident unitholder may not be able to exit investments in units of the Investment Vehicles by

exercising an option/ right to exit.

Further, these units could be pledged by the non-resident unitholder to secure credit facilities.

3. Downstream investments by Investment Vehicles

When treated as foreign investment?

Downstream investments by an Investment Vehicle shall be regarded as foreign investment if neither the Sponsor nor the Manager nor the Investment Manager is Indian-'owned and controlled'.

For this purpose, ownership and control of companies is to be determined in accordance with the regulations² laid down in this regard. For entities other than companies, SEBI shall determine whether or not the entity is foreign owned and controlled.

As ownership and control of an LLP cannot be determined under the extant FDI Policy, an LLP shall not act as sponsor or manager/ investment manager of an Investment Vehicle.

Implications

a) Downstream investments in companies

Downstream investment to conform to sectoral caps and conditions/ restrictions, if any, as applicable to the company in which the downstream investment is made.

b) Downstream investment in an LLP

Downstream investment has to conform to the provisions of the scheme for Foreign Direct Investment in LLPs³ as well as the extant FDI policy for foreign investment in LLPs.

4. Other restrictions/ conditions

Specific to AIFs

'Control' of the AIF should be in the hands of 'sponsors' and 'managers/ investment managers', with the general exclusion of others.

In case the 'sponsors' and 'managers/investment managers' of an AIF were individuals, for the treatment of downstream investment by such AIF as domestic, 'sponsors' and 'managers/investment managers' should be resident Indian citizens.

An AIF - Category III with foreign investment shall make portfolio investment in only those securities or instruments in which an RFPI is allowed to invest.

5. Procedural conditions

a) The payment for the units of an Investment Vehicle to be made by an inward remittance through normal banking channels, including by debit to an NRE or an FCNR account.

b) Investment Vehicle to report to RBI or SEBI in the prescribed format.

² Regulation 14 of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

³ Schedule 9 of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000

6. Definition of “real estate business”

In the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000, “real estate business” has been regarded as a prohibited sector for foreign investment.

These regulations have now been amended to exclude REITs registered and regulated under the SEBI (REITs) Regulations 2014, from the ambit of “real estate business”.

The takeaways

The introduction of these regulations by the RBI was much awaited by various players across several industries.

While it results in opening up a variety of investment opportunities to Foreign Investors, it also simultaneously provides domestic fund managers with an opportunity to manage these investments. More importantly, it could help in providing a much needed impetus to the Indian economy by providing an alternative source of

finance to crucial sectors of the economy.

Let’s talk

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

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