



भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CONSULTATION PAPER

DEPARTMENT OF DEBT AND HYBRID SECURITIES – POD II

CONSULTATION PAPER ON INTRODUCTION OF REGULATORY FRAMEWORK FOR RESTRICTED RETURN INVITs

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भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

Timeline to Respond

Comments on the
Consultation paper (CP) may
be sent by November 13, 2024

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1. **OBJECTIVE**

- 1.1. The objective of this consultation paper is to seek comments / views / suggestions from the public on proposals related to introduction of regulatory framework for restricted return InvITs.

2. **BACKGROUND**

- 2.1. SEBI (Infrastructure Investment Trusts) Regulations, 2014 (“InvIT Regulations”) were notified on September 26, 2014. InvIT Regulations and circulars issued thereunder provide the regulatory framework for InvITs. In terms of InvIT Regulations, InvITs can employ either of the two structures permitted under the regulations, viz. Publicly offered and listed & privately placed and listed,
- 2.2. InvITs were introduced in India to provide investors with an opportunity to gain exposure to infrastructure projects, with diversification of risks through pooling arrangement. It was envisaged that InvITs would provide investors with stable distributions through their passive ownership of income producing infrastructure projects
- 2.3. Public InvITs invest majorly in completed and income generating real estate assets. Privately placed InvITs can invest in under-construction assets as well as completed and revenue generating assets.
- 2.4. As on date, 26 InvITs are registered, out of which 21 InvITs have raise funds through initial offers and their units are listed on the stock exchange platform. The gross value of assets of InvITs is approx. 6.4 lakh crores.
- 2.5. Under the InvIT structure, it is desired that all rewards and benefits related to the underlying asset should flow to the unitholders and the benefits accrued on account of acquisition of assets and managing such assets should not be restricted. However, during thematic inspection of SEBI registered InvITs with respect to capital structure of SPVs/Holcos of InvITs it was observed that SPVs of certain InvITs entered into an agreement with sponsors, sponsor group or pre disclosed counterparties for providing additional benefits in terms of sharing of excess return/ or revenue of the SPVs beyond a certain threshold. In essence, the return to unitholders is managed and restricted to certain threshold as guided by the different agreements executed by the SPVs.

- 2.6. During interaction with investors, it is observed that such arrangements were known at the time of investment and factored in the investment decision.
- 2.7. Considering that the demand exists for such transactions where returns to unitholders are potentially structured to provide a floor or cap or a collar in respect of returns. These structured transactions allow unitholders to receive assured returns, albeit with a cap on the upside and/or protection on the downside return generated by the assets owned by the InvIT. Hence, it is proposed to explore the regulatory framework for Restricted Returns InvITs.

3. GLOBAL SCENARIO

- 3.1. Similar structures are prevalent globally, such as the Defined Outcome ETFs or Buffer ETFs, which seeks to provide investors with the upside of an asset's returns (generally up to a capped percentage) while also providing downside protection on the first predetermined percentage of losses (for example, on the first 10% or 15%).
- 3.2. The quick overview of how these work are as under:
 - 3.2.1. Downside Protection: These ETFs use options strategies, such as put spreads, to limit losses during a specified period, typically one year.
 - 3.2.2. Upside Cap: In exchange for this protection, the potential gains are capped. This means you won't benefit from all the market's upside.
- 3.3. These instruments have gained popularity, particularly among risk-averse investors and those nearing retirement, due to their ability to balance exposure to market gains with a defined level of risk management.
- 3.4. The success of Defined Outcome and Buffer ETFs in global markets indicates that there is a strong demand for products that offer predictable, risk-adjusted returns. India, with its growing pool of retail and institutional investors, is well-positioned to introduce such products, particularly through the infrastructure asset-backed InvITs. Given the volatility often associated with infrastructure investments, a structured product that provides downside protection on returns and/or an upside restrictions on returns could appeal to investors, especially those seeking long-term, stable returns.

4. **PROPOSED REGULATORY FRAMEWORK**

4.1. The introduction of regulatory framework for restricted return InvIT shall be with an underlying of infrastructure asset wherein the return on the investment is restricted in any of the following manner:

4.1.1. Downside Protection on returns (Floor on returns): Fixed return as a percentage of investment to be paid to the investor even if the investment vehicle does not generate sufficient return. In such case, for any deficit in return compared to the floor, the sponsor or any sponsor group entity or pre-disclosed counterparties are required to bring funds to ensure minimum return to the unitholders.

4.1.2. Upside Restriction on returns (Cap on returns): The return on the investment vehicle is capped at certain percentage of the investment even if the investment vehicle generates surplus return. In such case, the surplus return generated by the asset is typically distributed to the sponsor or any sponsor group entity or pre-disclosed counterparties.

4.1.3. Both Downside Protection and Upside Restriction on returns (Floor and Cap on returns): The return on the investment vehicle has the combination of both downside protection and upside restriction as detailed in Para 4.1.1 and 4.1.2 above.

4.2. However, such InvIT with restricted returns should be restricted only to sophisticated investors who are in position to understand the impact of such floors and/or caps on returns. Hence, such restricted return InvITs should be permitted only for privately placed InvITs with higher minimum investment and minimum trading thresholds.

4.3. Such InvIT should be permitted only for InvITs with significantly large value of assets.

4.4. Hence, Restricted return InvIT shall be permitted only in the following cases:

4.4.1. The InvIT is a privately placed InvIT

- 4.4.2. *The value of assets is minimum [Rs. 50,000 crores]*
- 4.4.3. *The minimum investment lot and minimum trading lot is [Rs. 500 cores]
(i.e. Face Value of each unit should be minimum Rs. 500 crores)*
- 4.5. It is also proposed that an investor must sign and submit a waiver cum undertaking form before investing in the units of Restricted return InvIT. The waiver cum undertaking form shall, inter-alia, include the following undertaking and confirmation:
- 4.5.1. The investor has the independent ability and mechanism to carry out due diligence of their investments, as well as to monitor the operations and compliance with the terms of placement memorandum of the Restricted return InvIT.
- 4.5.2. The investor has understood the feature of the restricted return InvIT and how it can restrict their returns.
- 4.5.3. The investor has understood that the investment has upside restriction on the returns and the excess return, if any, shall be distributed to sponsor or any sponsor group entity or pre-disclosed counterparties
[Applicable in case of upside restriction (with or without downside protection) on returns]
- 4.5.4. The investor has understood that the investment has downside protection on the return and that the same is dependent on the defined upfront contractual arrangement between the InvIT/HoldCos/SPVs and the sponsor or sponsor group entities or pre-disclosed counterparties and the credit rating. The investor has further understood that in the event of failure to fulfil such defined upfront contractual commitment by the sponsor or sponsor group entities or pre-disclosed counterparties, the InvIT may not be in position to fulfil the downside protection on returns.
[Applicable in case of downside protection (with or without upside restriction) on returns]

Further, to ensure uniformity, the Bharat InvIT Association shall specify a format for the waiver cum undertaking form in consultation with SEBI.

- 4.6. Since the units of restricted InvIT shall be listed on the stock exchange platform, hence investors can invest in the units of restricted return InvIT through primary market as well as secondary market. In this regard, following is proposed for collection of waiver cum undertaking form from the investors prior to making investment in the units of restricted return InvIT:

4.6.1. Primary Market:

In case investor subscribes to the units of restricted return InvIT in primary market, the aforementioned form shall be collected by the market intermediaries including merchant banker at the time of receiving the application in the offer. Further, the Merchant Banker and Investment Manager shall ensure that the said form has been collected before accepting the application in the offer.

4.6.2. Secondary market:

In case investor acquires units of restricted return InvIT in the secondary market, then the aforementioned form shall be collected by the stock broker before placing buy order in the stock exchange platform on behalf of the investor.

Further, in case investor acquires units of restricted return InvIT in off market transfer, then depositories/ depository participants shall ensure that the waiver cum undertaking form has been collected from the acquirer of the units before effecting transfers in depositories/depository participants records

- 4.7. Such downside protection and/or upside restriction on returns should be on the basis of **pre-defined upfront agreements** with sponsor or sponsor group entities or pre-disclosed counterparties.

- 4.8. Further, in case of InvITs with upside restriction on returns, any excess return is being distributed to the sponsor and/or any sponsor group entities or pre-disclosed counterparties.
- 4.9. However, in case of InvITs with downside protection on returns, any deficit return has to be funded by sponsor and/or any sponsor group entities or pre-disclosed counterparties.
- 4.10. To ensure that such consequential liability is honoured by sponsor and/or any sponsor group entities or pre-disclosed counterparties., there is a merit to levy additional investors protection to safeguard the interest of investor in such case. Hence, in case of Restricted Returns InvITs with downside protection on returns (with or without upside restriction on returns), it is proposed to put in place the following additional conditions for protection of investor interest:
- 4.10.1. There should be periodic evaluation on the performance of the InvIT assets.
- 4.10.2. In cases where the InvITs assets are not able to generate sufficient return equivalent to the downside protection return, there should be defined upfront contractual arrangement for transfer of funds by the sponsor and/or sponsor group entities or pre-disclosed counterparties on an immediate basis.
- 4.10.3. An independent Credit Rating Agency shall be required to provide credit rating on the ability of the concerned sponsor and/or sponsor group entities or pre-disclosed counterparties to perform the defined upfront contractual arrangement/commitment,
- 4.10.4. The credit rating by Credit Rating Agency would form a critical part of the risk management framework, ensuring that only those InvITs with a credible guarantee of performance and/or ascertained in the defined upfront contractual commitments are approved. Such credit rating report should form part of placement memorandum.

- 4.10.5. The placement memorandum should contain a prominent risk factor disclosure mentioning that the downside protection is dependent on the defined upfront contractual arrangement between the InvIT/HoldCos/SPVs and the sponsor and/or sponsor group entities or pre-disclosed counterparties and the credit rating. In the event of failure to fulfil such defined upfront contractual commitment by the sponsor and/or sponsor group entities or pre-disclosed counterparties, the InvIT may not be in position to fulfil the downside protection on returns.
- 4.11. Further, in case of Restricted Returns InvITs with upside restriction on returns (with or without downside protection on returns), the placement memorandum should have prominent disclosure on capping of returns.
- 4.12. The proposed framework would facilitate the introduction of innovative investment products while safeguarding investor interests, thereby contributing to the overall development of the securities market.

Consultation:

Kindly provide your comments along with supporting rationale on the following:

- 1) Whether the proposal to introduce regulatory framework for restricted return InvIT is appropriate?
- 2) Whether the proposal that the restricted return can be in nature of either downside protection on returns or upside restriction on returns or a combination of both is appropriate?
- 3) Whether the introduction of this framework for privately placed InvIT is appropriate?
- 4) Whether the minimum asset value of Rs. 50,000 crores is appropriate?
- 5) Whether the minimum investment lot and minimum trading lot and Face value of each unit of Rs. 500 crores is appropriate?
- 6) Whether the proposal with regard to submission of waiver cum undertaking form as proposed in Para 4.5 above is appropriate?
- 7) Whether the process of collection of waiver cum undertaking form as proposed in Para 4.6 above is appropriate?
- 8) Whether the proposal to mandate periodic evaluation on the performance of InvIT assets, as stated in Para 4.10.1 above, is appropriate? Kindly indicate frequency for such periodic evaluation.
- 9) Whether the proposals to mandate credit rating of defined upfront contractual agreement by Credit Rating Agencies, as stated in Paras 4.10.3 and 4.10.4 above, is appropriate?
- 10) Whether the disclosure of prominent risk factor, as proposed in Para 4.10.5 above, is appropriate?

5. **PUBLIC COMMENTS**

5.1. Considering the implications of the aforementioned matters on the market participants, public comments are invited on the above-detailed proposals. The comments/ suggestions should be submitted latest by November 13, 2024, through the online web-based form which can be accessed using the following link:

<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

5.2. Kindly go through the instructions mentioned on the above link before submitting comments on the consultation paper

5.3. In case of any technical issue in submitting your comment through web based public comments form, you may contact the following through email with a subject: *"Issue in submitting comments on Consultation Paper on Introduction of Regulatory Framework for Restricted Return InvITs"*.

a) Ritesh Nandwani, DGM (riteshn@sebi.gov.in)

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