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REITS AND INVITS: SEBI INTRODUCES NORMS FOR DE-CLASSIFYING SPONSORS, INDUCTION OF A SPONSOR AND RELAXES SPONSOR LOCK-IN REQUIREMENTS

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Background

India's capital markets regulator, the Securities and Exchange Board of India (SEBI) has, on 16 June 2020, notified amendments (Amendments) to the Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014 (InvIT Regulations) and Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 (REIT Regulations). The Amendments, *inter alia*, allow de-classification of persons and entities as sponsors, induction of new sponsors, introduce whitewash waiver provisions for Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs) (together, Business Trusts), and ease lock-in requirements in case of REITs.

Salient features of the Amendments

I.	Declassification of sponsor(s):
	Sponsor(s) of Business Trusts whose units have been listed on the stock exchanges for at least three years are now permitted to declassify themselves as sponsor(s) of the Business Trust. Such declassification may be permitted, subject to the person or entity, proposing to declassify itself as a sponsor, complying with the following conditions at the time of making such application:
	a. Such sponsor, together with its associates, does not hold more than 10% of the outstanding units of the Business Trust;
	b. Such sponsor and its associates do not exercise control of the manager of the Business Trust;
	c. Prior approval of the unitholders shall be obtained for such declassification, and such resolution may be approved by a simple majority. However, a conflicting clause remains in the REIT Regulations and InvIT Regulations, which require approval from 75% of the unit holders by value for <i>any change in sponsor</i> . Given that declassification of a sponsor could tantamount to a change in sponsor, this ambiguity would require further clarification;

	<p>d. Additionally, in case of a REIT, given that natural persons are allowed to be sponsors, such sponsor or its associates shall not be fugitive economic offenders.</p>
<p>II.</p>	<p>Removal of perpetual lock-in requirements for the sponsor(s) and sponsor group of a REIT</p>
	<p>Prior to the Amendments, pursuant to the provisions of Regulation 11 of the REIT Regulations, each sponsor was required to hold at least 5% of the outstanding units of the REIT through the life of the REIT. Further, the sponsor(s) and its sponsor group were required, in aggregate, to hold at least 15% of the outstanding units of the REIT at all times. Any sale below such specified thresholds was only possible subject to the purchaser re-designating itself as a sponsor of the REIT. Pursuant to the Amendments, SEBI has done away with this perpetual lock-in of sponsor and sponsor group holdings under Regulation 11 of the REIT Regulations. As a consequence, the post-listing lock-in requirements imposed on the sponsors and their respective sponsor group, in aggregate, is 25% of the outstanding capital for a three-year period only. Further, the sponsor and sponsor group's unit holding over and above 25% shall be locked for a period for one year from the date of listing. The Amendments have accordingly sought to align the lock-in period stipulated under the REIT Regulations, with the InvIT Regulations.</p> <p>However, a dichotomy exists in Regulation 4 of the REIT Regulations, which requires each sponsor to hold not less than 5% of the number of units of the REIT on post-initial offer basis, has not been amended. In the absence of further clarity or amendment from SEBI on this requirement under Regulation 4, it remains unclear if the deletion of perpetual lock-in under Regulation 11 could have the desired effect.</p>
<p>III.</p>	<p>Induction of a new sponsor</p>
	<p>Prior to the Amendments, re-designation of an existing sponsor and change in control of a sponsor was allowed only in case of REITs. Given the similarity in structures and roles of sponsors in both REITs and InvITs, InvITs are now permitted to induct new sponsors and allow for a change in control of existing sponsors – thereby, aligning the concept with that of a REIT. It has also been clarified, both in case of REITs and InvITs, that induction of a new sponsor may be undertaken with or without exit of an existing sponsor. SEBI has also prescribed certain whitewash waiver provisions in case of induction of a sponsor / change in control of a sponsor which have been discussed in detail below.</p> <p>It is pertinent to note that unlike in case of change in manager/change in control of the manager of a Business Trust, an approval of SEBI has not been specifically prescribed for induction of new sponsor. Needless to say, any inducted sponsor would have to fulfil the eligibility criteria prescribed for a sponsor of a Business Trust, which include, <i>inter alia</i>, minimum net worth criteria and minimum experience requirement in the infrastructure/real estate sector as specified in the relevant regulations.</p> <p>Read together with the removal of the perpetual lock-in requirements as stated above, the Amendments have effectively permitted a new person or entity to be inducted as a sponsor without requiring a “skin in the game” – such a person or entity is not required to hold any minimum number of units in the Business Trust. However, in the absence of clarification to Regulation 4 of the REIT Regulations, it could be argued that if a sponsor is inducted in the first three</p>

	years post listing of a REIT, such sponsor would be required to hold at least 5% of the unit capital of such REIT.
IV.	<i>Acquisition of more than 25% of the units of a Business Trust</i>
	<p>Prior to the Amendments, the maximum investment by any person in a listed InvIT was capped at 25% and in case of REITs was capped at 50% of the aggregate units outstanding; with an exception for sponsor(s), their related parties and associates. Through the Amendments, SEBI has aligned the requirements in the REIT Regulations and InvIT Regulations. Any person (taken together with units held by such person and by persons acting in concert with such person) proposing to acquire units of a Business Trust in excess of 25% of the value of the outstanding units, is required to comply with the whitewash waiver provisions as stated below.</p> <p>SEBI has also clarified that any investment through the initial offer of a Business Trust would remain capped at 25% (other than for sponsors, its related parties and associates). The option to increase such holding beyond 25% would only be available post-listing of the units, subject to compliance with the conditions as stated above.</p> <p><i>Whitewash waiver provisions (in respect of (III) and (IV) above)</i></p> <p>Any change in the sponsor(s) or inducted sponsor of a Business Trust or a change in control of a sponsor would require prior approval of at least 75% of the unitholders by value. Similarly, any investor (other than the sponsor(s), its related parties and associates) proposing to acquire more than 25% units of a Business Trust (Significant Investor) (taken together with the holding of persons acting in concert with such investor) shall require prior approval from the 75% unitholders by value. For the purposes of obtaining such approval, the value of units held by any person related to the transaction shall not be considered. It is important to note that the threshold of 25%, considered as a trigger for whitewash waivers is aligned with the bright line of control adjudged by SEBI in case of equity listed companies as well.</p> <p>If the inducted sponsor/sponsor undergoing a change in control/ Significant Investor fails to obtain the necessary approval of the unitholders as set out above, such person shall be required to provide an exit option to the dissenting unit holders, by buying their units in the manner which may be specified by SEBI. It is expected that the specific procedure and pricing in case of such an exit offer will be separately notified by SEBI.</p>
V.	Broadening the definition of “strategic investors”: The definition of a “strategic investor” under the InvIT Regulations and the REIT Regulations has been broadened to include insurance companies registered with the Insurance Regulatory and Development Authority of India (IRDAI) and mutual funds.
	The inclusion of mutual funds and insurance companies registered with IRDAI within the category of “strategic investors” will help InvITs and REITs attract a broader range of strategic investors for initial public offerings of their units.

Comment

Declassification of sponsors and removal of perpetual lock-in: SEBI’s move of doing away with the perpetual lock-in requirement should be welcomed by sponsors of REITs. This amendment will enable sponsors of a REIT to monetize their unitholding and fully exit from the portfolio after the initial three-year period from the date of listing. Further,

SEBI has also allowed declassification after such three-year period post listing, enabling not only a full exit by sponsors, but also making it clear that sponsors, upon declassification, can delineate themselves from continuing liability and obligations towards the Business Trust. While the essence of the obligations of sponsors to bring 'skin in the game' has been preserved in the Amendments, in case of a REIT, the removal of a lifetime obligation to maintain such 'skin in the game' is welcome.

Induction of sponsors and Significant Investors: SEBI's move towards lifting the cap on unitholding of Significant Investors from 25% will enable investors to increase their stake in a listed Business Trust in the future without being designated as a sponsor. Further, we note that the applicability of whitewash waivers has been made consistent for induction of a sponsor and a Significant Investor. We also note that SEBI has prescribed that while calculating the unitholding for the purposes of the above, unitholding of the "persons acting in concert" shall be considered. The exact scope and definition of this phrase is expected to be notified by SEBI separately. Further, while investments by an Significant Investor in an unlisted InvIT is not capped at 25% through an initial offer, pursuant to the Amendments, it could be argued that Significant Investors proposing to acquire more than 25% of the outstanding units in an unlisted InvIT would have to comply with the whitewash waiver provisions.

In a nutshell, the Amendments are strides in the right direction and will provide sponsors' investments some much needed liquidity and will enable sponsors to better monetize their assets, allow participation by new sponsors and also allow significant investments by investors, with necessary safeguards.

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