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SEBI Revamps InvIT Regulations

Introduces the Concept of Subordinate-Units



1. Introduction

The Securities and Exchange Board of India (SEBI) has recently announced significant amendments to the Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014. These amendments, outlined in SEBI/LAD-NRO/GN/2024/182, aim to enhance the regulatory framework governing Infrastructure Investment Trusts (InvITs) and ensure greater transparency and investor protection within the sector. This write-up discusses in detail the key changes introduced by SEBI, including the introduction of subordinate units, refinements to eligibility criteria for unitholders, and the establishment of clear procedures for the issuance, transfer, and reclassification of subordinate units.

2. Introducing the concept of 'Subordinate Units'

SEBI's amendment introduces the concept of subordinate units within the framework of InvITs. Subordinate units are instruments issued by an InvIT that can be reclassified as ordinary units[1]. Further, the SEBI has also issued the 'Framework for Issuance of Subordinate Units' in Chapter IVA of SEBI (Infrastructure Investment Trusts) Regulations, 2014. Further, these units are issued in dematerialised form and have distinct International Securities Identification Numbers (ISINs) from ordinary units.

3. What is a Subordinate Unit? How is it different from Ordinary Units?

As discussed above, the Subordinate units are instruments issued by an Infrastructure Investment Trust (InvIT) that can be reclassified as ordinary units. They are primarily issued as part of the acquisition consideration for infrastructure projects. Subordinate units do not have voting rights or distribution rights until they are reclassified as ordinary units. Whereas, Ordinary units have voting and distribution rights from the outset.

Ordinary units are issued to the general public or investors during the initial public offering (IPO) or other fundraising activities, while subordinate units are issued specifically to the sponsor, its associates, and the sponsor group as part of the acquisition consideration.

1 Section 2(zzaa) of SEBI (Infrastructure Investment Trusts) Regulations, 2014

Further, Ordinary units do not require reclassification before trading on stock exchanges, unlike subordinate units. Also, the transfer and encumbrance of subordinate units are highly restricted and can only be transferred to the sponsor, its associates, or entities within the sponsor group. Ordinary units do not have such stringent restrictions on transfer and encumbrance.

4. New Eligibility Criteria: What Changes are introduced for Unitholders in InvITs?

A new sub-clause (i) shall be inserted in Regulation 4(2)(i), and a new condition in eligibility criteria has been introduced. Now, the unitholders holding not less than ten per cent of the total outstanding units of the InvIT, either individually or collectively, shall:

(a) Nominate one director on the Investment Manager's board, with specified recusal provisions to ensure impartiality.

(b) Adhere to the stewardship code outlined in Schedule VIII of the InvIT regulations.

5. What is the procedure for issuance of Subordinate Units?

The issuance of subordinate units by Infrastructure Investment Trusts (InvITs) follows a structured process governed by SEBI regulations. These units, issued in dematerialized form to sponsors and their associates, must comply with pricing guidelines and undergo reclassification before listing. Unitholder approval is required for issuances beyond the initial offer, with strict limits on the total amount issued. The procedure for the issuance of subordinate units is discussed as under:

5.1. Structured Process for Issuance

Infrastructure Investment Trusts (InvITs) will issue subordinate units following a structured process governed by SEBI InvITs Regulations. Upon the acquisition of an infrastructure project, privately placed InvITs are authorized to issue subordinate units exclusively to the sponsor, its associates, and the sponsor group.

5.2. Dematerialized Issuance and Reclassification

These units, deemed part of the acquisition consideration, are issued in dematerialized form with distinct International Securities Identification Numbers (ISINs) from ordinary units. Subordinate units lacking voting and distribution rights must undergo reclassification into ordinary units before listing on recognized stock exchanges. This reclassification process necessitates in-principle approval from the stock exchange.

5.3. Pricing Compliance and Disclosure

The pricing of subordinate units adheres to guidelines applicable to ordinary units. The terms and conditions, including potential reclassification impacts, are disclosed in a Term Sheet provided by the investment manager. This information is also shared in placement memorandums and notices for unitholders' meetings, ensuring transparency.

5.4. Issuance Limits and Exceptions

The issuance of subordinate units after the initial offer requires unitholder approval, with specific provisions to prevent conflicts of interest among parties involved in the acquisition.

Notably, the total issuance of subordinate units is capped at ten per cent of the acquisition price of the infrastructure project and must not exceed ten per cent of outstanding ordinary units. Exceptions may be made for InvITs with pre-existing subordinate units, subject to compliance with prescribed limits.

6. Are Subordinate Units in an InvIT Freely Transferable?

The transfer of subordinate units in an infrastructure investment trust (InvIT) is subject to stringent regulations outlined by SEBI. According to Section 17C of the SEBI (Infrastructure Investment Trusts) Regulations, 2014, subordinate units must remain locked in until reclassified into ordinary units. Furthermore, these units cannot be transferred to any individual except the sponsor, its associates, or entities within the sponsor group.

Similarly, encumbrances on subordinate units are restricted to the sponsor, its associates, or sponsor group entities. The depository is prohibited from registering transfers or encumbrances unless the recipient is a sponsor, associate of the sponsor, or a part of the sponsor group.

The investment manager must promptly disclose any transfer or encumbrance of subordinate units to the recognized stock exchange within one working day.

Additionally, in the event of a change in sponsor, the outgoing sponsor is obligated to transfer any subordinate units it holds to another sponsor, its associates, or entities within the sponsor group.

7. When can Subordinate Units in an InvIT be reclassified as Ordinary Units?

The SEBI's regulations stipulate clear definitions and specifications for the entitlement date, entitlement event, and performance benchmark concerning the reclassification of subordinate units to ordinary units within an infrastructure investment trust (InvIT).

The term Sheet provided to investors outlines these parameters in detail. The performance benchmark for reclassification must be quantifiable, objective, and based on audited financial statements, ensuring transparency and accountability.

Additionally, there is a minimum three-year period between the issuance of subordinate units and the entitlement date for reclassification. Any extension of the entitlement date must adhere to strict conditions, including limits on the duration and reasons for extension, with approval required from unitholders.

8. What are the Reporting and Disclosure Requirements for Performance Benchmark in InvITs?

The investment manager shall monitor progress related to achieving the performance benchmark and shall report such progress annually or with other prescribed frequency after certification by the statutory auditor of the InvIT and approval of the trustee and the audit committee of the investment manager.

The investment manager shall disclose the progress related to achievement of performance benchmark in the Annual Report of the InvIT. The investment manager shall also disclose the diluted NAV and the diluted distribution per unit to the stock exchange along with NAV and distribution per unit until subordinate units are outstanding.

9. Process and Requirements for Reclassification of Subordinate Units in InvITs

The reclassification of subordinate units into ordinary units in InvITs involves a thorough certification, review, and approval process. This ensures that performance benchmarks are met before reclassification, with strict compliance and notification procedures to relevant authorities and stock exchanges. The procedure for Reclassification of Subordinate Units in InvITs is summarised as follows:

9.1. Certification and Review of Performance Benchmark

The status of achieving the performance benchmark for reclassifying subordinate units to ordinary units must be certified by the statutory auditor of the InvIT. This certification is then reviewed by the trustee and the audit committee of the investment manager.

9.2. Reclassification Upon Achievement of Benchmark

If the performance benchmark is met by the entitlement date, including any extensions, subordinate units will be reclassified into an equal number of ordinary units on a *pari-passu* basis according to the Term Sheet's terms and conditions. Reclassification can occur for all subordinate units together or in parts, depending on the achievement of performance benchmarks as specified in the Term Sheet.

9.3. Non-Achievement of Benchmark

If the performance benchmark is not achieved by the entitlement date, including any extensions, the subordinate units will be extinguished without paying their holders.

9.4. Board Consideration and Trustee Approval

The board of directors of the investment manager will assess the reclassification or extinguishment of subordinate units based on the performance benchmark's achievement. They will pass a resolution recommending the necessary action to the trustee. The trustee will then consider this recommendation and, after ensuring compliance with regulations, may approve the reclassification or extinguishment and inform the investment manager accordingly.

9.5. Intimation and Disclosure

Following the trustee's approval, the investment manager must notify the recognized stock exchange, depositories, and the Registrar and Transfer Agent. This notification must include the record date, which should be disclosed at least two working days prior to the record date, excluding the date of intimation and the record date itself. The record date is defined as the date from when subordinate units will be reclassified as ordinary units.

9.6. Listing on Stock Exchange

Once reclassified as ordinary units, the subordinate units will be listed on the recognized stock exchange(s) upon receiving final listing and trading approval from these exchanges.

10. Concluding Note

By introducing subordinate units, refining eligibility criteria, and establishing clear processes for issuance, transfer, and reclassification, SEBI aims to promote greater transparency, accountability, and investor protection within the sector. These measures collectively contribute to the robust and transparent functioning of InvITs, fostering a more secure and attractive environment for infrastructure investment in India.

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