REGULATORY FRAMEWORK FOR INVESTMENT FUNDS IN IFSC (GIFT CITY) PROPOSED IN LINE WITH GLOBAL BEST PRACTICES | LISTED COMPANIES TO SEEK NOC FROM 75% OF SECURED CREDITORS IN VALUE FOR M&A SCHEMES

A. IFSCA issues draft regulations for the framework of investment funds in the International Financial Services Centre (IFSC) region

With a view to develop the framework for investment funds in IFSC, the International Financial Services Centre Authority (**IFSCA**) has proposed to issue IFSCA (Fund Management) Regulations, 2022 (**Draft Fund Management Regulations/Draft Regulations**), based on global best practices, focusing on the ease of doing business. A Committee of Experts on Investment Funds was set up by IFSCA to review global best practices and make recommendations to the IFSCA on the roadmap for the industry, and accordingly a committee report has been tabled before the IFSCA, and Draft Fund Management Regulations have been issued for public comments.

The Draft Regulations propose to govern retail schemes, non-retail schemes such as alternative investment funds (AIFs), portfolio management schemes (PMS), investment trusts such as REIT and InvIT, ESG schemes, self-managed family investment fund and other fund management activities. The Draft Regulations propose to inter alia repeal SEBI (Alternative Investment Funds) Regulations, 2012, SEBI (Mutual Funds) Regulations, 1996, with respect to their applicability in IFSC. Some of the key proposals include:

- A green channel route to launch schemes, which will essentially allow launching of the schemes for subscription immediately upon filing with the IFSCA. This has been made available to Venture Capital Schemes or non-retail schemes soliciting money from accredited investors only;
- Family investment fund recognition;
- A unified registration for multiple fund activities;
- Relocation benefits, as the minimum contribution requirement will not be mandatory in case of relocation of funds /schemes established or incorporated or registered outside India to IFSC;
- Gold and Silver ETF fund managers can invest in Bullion Depository Receipts;
- Liberal co-investment regime through a special purpose vehicle (SPV) or through a segregated portfolio by issuing a separate class of units;
- Innovation to fund activities (fund lab);
- Venture capital schemes for investing in primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings;
- Leverage and borrowing permitted for funds;
- Investment up to a certain limit in physical assets such as real estate, bullion, art or any other physical asset. This would be an interesting avenue for art funds;
- Launching of retail schemes such as mutual funds opening avenues for cross-border investments. They can also launch ETFs, which can be either equity, debt, commodity, hybrid, actively managed, etc.;
- Special situation funds (SSFs) to invest in special situation asset – recently SEBI in the domestic space, had also recognized these funds;
- Focus on ESG: A fund management entity managing AUM above USD 1 Billion as at the close of a financial year is required to have specified ESG governing mechanism in place, in addition to other ESG focused funds;
- Setting up of investment trusts such REIT and InvIT;
- Special regime for accredited investors;

- Other specifications such as code of conduct, advertisement code, business continuity plan, cyber security and cyber resilience, risk management and internal controls, prohibition on guaranteed returns except in certain specified circumstances, etc.

B. **<u>SEBI issues amendment to the master circular on scheme of arrangement by listed entities</u>**: SEBI has clarified that a no-objection certificate (**NOC**) must be obtained from lending scheduled commercial banks/ financial institutions/ debenture trustees, from not less than 75% of the secured creditors in value.

The above changes have been analyzed below.

A. IFSCA issues draft regulations for the framework of investment funds in IFSC region

The IFSCA had constituted an expert committee on investment funds (**Expert Committee**) to recommend to IFSCA on the road map for the funds industry in the IFSCs. Upon examination of the report of the Expert Committee (<u>available here</u>), IFSCA has framed the Draft Fund Management Regulations to provide for a comprehensive regulatory framework for activities related to fund management. In the table below, we have summarized and analyzed certain key proposals:

<table>
<tr><th>Proposed Regulation</th><th colspan="2">Explanation / Analysis</th></tr>
<tr><td rowspan="4">Mandatory certificate of registration from IFSCA as a Fund Management Entity (FME)</td><td colspan="2">▪ <u>Certificate of Registration</u>: Any entity intending to undertake the business of fund management shall not commence operations in an IFSC unless it has obtained a certificate of registration from the IFSCA as a Fund Management Entity (FME).

▪ <u>Classification of FMEs:</u> In order to follow risk-based approach for supervision and facilitate entities to undertake activities dealing with sophisticated investors with ease, FMEs shall seek registration under any of the following categories:</td></tr>
<tr><td>Authorized FME</td><td>▪ FMEs that pool money from accredited investors or investors investing above the specified threshold by way of private placement and invest in start-ups or early-stage ventures through Venture Capital Scheme (VCS), and Family Investment Funds.</td></tr>
<tr><td rowspan="2">Registered FMEs</td><td><u>Non- Retail Registered FMEs:</u>
▪ FMEs that pool money from accredited investors or investors investing above a specified threshold by way of private placement for investing in securities, financial products and such other permitted asset classes through one or more restricted schemes.
▪ Such FMEs shall be able to launch schemes as permissible under the extant regulatory framework for AIFs in IFSC.
▪ Such FMEs shall be able to undertake Portfolio Management Services (including for multi-family office) and act as investment manager for private placement of Investment Trust (REITs and InvITs) (Investment Trusts) and shall also be able to undertake all activities as permitted to Authorized FMEs.</td></tr>
<tr><td><u>Retail Registered FMEs:</u>
▪ FMEs that pool money from retail and non-retail investors under one or more schemes for investing in</td></tr>
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Proposed Regulation	Explanation / Analysis
	securities, financial products and such other permitted asset classes through retail or restricted schemes. ▪ Such FMEs may act as investment manager for public offer of Investment Trusts and may also launch Exchange Traded Funds (**ETFs**). ▪ Further, such FMEs shall also be able to undertake all activities as permitted to Authorised FMEs and Registered FMEs (Non-retail). ▪ ***<u>No change in category:</u>*** A FME which has been granted registration under a particular category cannot change its category after registration, except with the prior approval of the IFSCA. ▪ ***<u>Continuity of present regulatory framework:</u>*** To ensure continuity of the present regulatory framework for funds in IFSC, Registered FMEs (Non-Retail) shall be able to launch schemes as permissible under the extant regulatory framework for Alternative Investment Funds in IFSC and Authorised FMEs shall be able to launch schemes similar to angel fund / Venture Capital category under the extant regulatory framework for Category I Alternative Investment Fund. ▪ ***<u>Validity of Certificate of Registration</u>***: The certificate of registration of FME shall be valid for such period as may be specified, unless it is suspended or cancelled by the IFSCA or surrendered by the FME and taken on record by the IFSCA.
Eligibility conditions of applicants seeking certificate of registration from the IFSCA	**Legal form of the applicant** ▪ Applicant shall be present in an IFSC by forming a company or limited liability partnership (**LLP**) or branch thereof or any other form as may be permitted by the IFSCA, subject to certain conditions; ▪ A Registered FME (Retail) is not permitted through LLP mode or its branch; ▪ Branch structure is permitted only for a FME which is already registered and/or regulated by a financial sector regulator in India or a foreign jurisdiction for conducting similar activities. ▪ Activity of fund management should be permitted by the memorandum of association in case of a company or the partnership deed in case of LLP; ▪ A Registered FME (Retail) shall have at least 4 directors with at least 50% of the directors to be independent directors. **Sound Track Record** The applicant shall have a sound track-record and general reputation of fairness and integrity in all its business transactions. "sound track record" shall mean - ▪ <u>Registered FME (Retail)</u>: FME or its holding company to have not less than 5 years of experience in managing Assets Under Management (**AUM**) of at least USD 200 million with more than 25,000 investors or at least 1 person in control of the FME holding more than 25% shareholding/share of profits in the FME be carrying on business in financial services for a period of not less than 5 years.

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<tr><th>Proposed Regulation</th><th colspan="2">Explanation / Analysis</th></tr>
<tr><td rowspan="3"></td><td></td><td>▪ <u>Registered and Authorized FME:</u> FME shall employ such employees who shall have relevant experience as may be prescribed under the Draft Regulations.</td></tr>
<tr><td>Net Worth Requirements</td><td>An entity seeking registration as a FME shall, at all times, comply with the net worth requirements:
▪ <u>Authorized FME</u>: USD 75,000
▪ <u>Registered FME (Non-retail):</u> USD 5,00,000
▪ <u>Registered FME (Retail):</u> USD 1,000,000</td></tr>
<tr><td>Other eligibility conditions</td><td>▪ Appointment of Principal Officer who shall be responsible for overall activities of the FME and one key managerial personnel(s) (KMP) as compliance and risk Manager.
▪ <u>Fit and Proper Persons</u>: The applicant and its principal officer, directors/ partners/ designated partners, key managerial personnel and controlling shareholders shall be fit and proper persons, at all times, as prescribed.
<u>Infrastructure</u>: The entity to have necessary infrastructure commensurate to the size of its operations in IFSC.</td></tr>
<tr><td rowspan="2">Schemes for Fund Management | Restricted Schemes (Non-Retail Schemes)</td><td>Eligible Schemes</td><td>Registered FMEs may launch schemes for various investment strategies including for:
(a) <u>Investments schemes construed as Category I AIFs:</u> Investing in start-up or early-stage ventures or social ventures or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable and shall inter alia include venture capital funds, social venture funds, infrastructure funds, ESG Funds, Special Situations funds and such other Schemes/Funds as may be specified by the IFSCA.

(b) <u>Investments schemes construed as Category III AIFs:</u> Investment in securities primarily of listed entities including for undertaking diverse or complex trading strategies and for permitted investments under longevity finance.

(c) <u>Investments schemes construed as Category II AIFs:</u> Investment which does not fall under (a) and (b) above.</td></tr>
<tr><td>Filing of placement memorandum</td><td>Registered FMEs may launch restricted schemes through a private placement by filing the placement memorandum with the IFSCA along with the application fees, 21 days before the of launch of the scheme. If IFSCA does not have any comments on the same, the FME may launch the scheme.
▪ <u>Validity of placement memorandum</u>: The validity of the placement memorandum shall be 6 months from the date of filing with the IFSCA or the date of observation letter of the IFSCA, whichever is later.
▪ <u>Green Channel</u>: The restricted schemes soliciting money only from accredited investors shall be</td></tr>
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Proposed Regulation	Explanation / Analysis	
		restricted schemes under a green channel and can open for subscription from investors immediately upon filing with the IFSCA.
	Eligible Investors	▪ Restricted schemes shall have less than 1000 investors or such number as may be specified by the IFSCA. ▪ Accredited Investors or investors investing above USD 150,000 may invest in such schemes. ▪ In case of investors who are employees or directors or designated partners of the FME, the minimum value of investment shall be USD 40,000.
	Nature of scheme	Restricted schemes may be launched as open ended or close ended schemes. In case of a close ended schemes, the maximum tenure and amount to be raised should be decided upfront and disclosed in the placement memorandum. The minimum tenure of a close ended scheme shall be 3 years.
	Permissible investments	A restricted scheme may invest the moneys collected under any of its schemes only in a specific list of instruments which *inter alia* include securities issued by unlisted entities, securities listed or traded on domestic/ foreign stock exchanges, money market instruments, debt securities and derivatives including commodity derivatives, etc. **Investment in physical assets:** A close ended scheme may invest up to 20% of the corpus in other physical assets such as real estate, bullion, art or any other physical asset as may be specified by the IFSCA from time to time. This will indeed be an interesting avenue for funds if they would like to explore physical assets as a potential investment mode.
	Investment Restriction	▪ In case of an open-ended scheme, maximum investment in securities of unlisted companies should not exceed 25% of the corpus of the schemes. ▪ Minimum size of the restricted schemes shall be USD 5 Million. Restricted schemes may invest in associate entities subject to the prior approval of 75% investors in the scheme by value.
	Disclosure to investors	▪ The placement memorandum for such FMEs shall *inter alia* disclose the investment objective, the targeted investors, proposed corpus, investment style or strategy, investment methodology and proposed tenure of the fund or scheme. ▪ Any material deviation or alteration to the fund strategy should be made with the consent of at least 2/3rd of investors by value. ▪ The FME shall ensure that the NAV is disclosed to the investors at least on a monthly basis in case of an open-ended scheme and half-yearly in case of a close ended scheme. ▪ The FME shall ensure that the portfolio under the scheme is disclosed to the investors at least on a quarterly basis within 1 month from the end of the quarter.
	Borrowing	A restricted scheme may borrow funds or engage in leveraging activities, subject to the following conditions:

Proposed Regulation	Explanation / Analysis	
		▪ The maximum leverage by the scheme, along with the methodology for calculation of leverage, shall be disclosed in the placement memorandum; ▪ The leverage shall be exercised subject to consent of the investors; ▪ The FME employing leverage shall have a comprehensive risk management framework appropriate to the size, complexity and risk profile of the fund.
	Valuation Norms	FMEs to value its investments in accordance with certain overarching principles to ensure fair treatment to all investors including existing investors as well as investors seeking to invest. These principles *inter alia* include: ▪ principles of fair valuation ▪ Identification of valuation methodologies ▪ Consistent valuation of assets held by FME ▪ Periodic review of the valuation policies and procedures.
	Computation of NAV	FME to compute the NAV of each restricted scheme at least on a monthly basis and in case of a close ended restricted scheme the computation of NAV shall take place at least half-yearly.
	Skin in the game	FME shall ensure that under a restricted scheme it shall invest at least: (a) In case of a close ended scheme, lower of 2.5% of the corpus of the scheme or USD 750,000; (b) In case of Open-ended scheme, lower of 5% of the corpus of the scheme or USD 1,500,000. The said contribution may be brought in by FME or its associate entity within 6 months from the date of launch of the scheme and shall be maintained on an ongoing basis, and such contribution, if brought in by FME, shall be included for the purpose of net worth requirements. **<u>Benefits of relocation:</u>** The contribution by the FME shall not be mandatory in case of relocation of funds /schemes established or incorporated or registered outside India to IFSC. **<u>Exemption from contribution</u>:** (i) If at least 2/3rd of the investors in the scheme by value permits waiver of such contribution; (ii) at least 2/3rd of the investors in the scheme are accredited investors; (iii) The scheme is a fund of fund scheme investing in a scheme which has similar such requirements.
	Co-investment	A restricted scheme may co-invest in permissible investments under these regulations through a SPV or segregated portfolio by issuing a separate class of units and shall ensure that: ▪ The investments by such segregated portfolios shall, in no circumstance, be on terms more favourable than those offered to the common portfolio of the restricted scheme; ▪ Appropriate disclosures have been made in the placement memorandum regarding creation of segregated portfolio.

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<tr><th>Proposed Regulation</th><th>Explanation / Analysis</th></tr>
<tr><td>Family Investment Funds (FIFs)</td><td>
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<tr><td>Legal form</td><td>Family Investment Fund could be set up in the IFSC as a Company, Trust (Contributory Trust only) or LLP or any other form as may be permitted by the IFSCA from time to time.</td></tr>
<tr><td>Minimum corpus</td><td>An entity intending to be a FIF in IFSC should have and maintain a minimum corpus of USD 10 million within a period of 3 years.</td></tr>
<tr><td>Nature of fund</td><td>Open-ended or close-ended, depending upon the requirements of the family.</td></tr>
<tr><td>Permissible activities</td><td>FIF may undertake all activities related to managing family investment fund and as may be specified by the IFSCA.</td></tr>
<tr><td>Permissible investments</td><td>FIF may invest money in a specific set of instruments which inter alia include securities issued by unlisted entities, securities listed or traded on domestic/ foreign stock exchanges, money market instruments, debt securities, derivatives including commodity derivatives, and physical assets such as real estate, bullion, art, etc.</td></tr>
<tr><td>Borrowing</td><td>FIF borrow funds or engage in leveraging activities as per their risk management ability.</td></tr>
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<tr><td>Schemes for Fund Management | Venture Capital Schemes (VCS)</td><td>VCS may be launched by Authorised FMEs or Registered FMEs by filing of placement memorandums.

<u>Investments</u>: VCS to invest primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property right based activities or a new business model or other schemes which invest in such entities and shall also include an angel fund.
<u>Eligible Investors</u>: (a) VCS to have less than 50 investors; (b) Accredited Investors or investors investing above USD 250,000 shall be permitted to invest in such schemes.
<u>Nature of scheme</u>: Only close ended schemes with a minimum tenure of 3 years.
<u>Corpus of scheme and investment Restrictions</u>: Minimum size of the corpus to be USD 5 million, and total corpus shall not exceed USD 200 million. Further, VCS shall invest at least 80% of the AUM in investee companies incorporated for less than 7 years or other VCS.
<u>Borrowing</u>: A VCS may borrow funds or engage in leveraging activities, subject to the certain conditions including disclosure of maximum leverage by the scheme in the placement memorandum.
<u>Computation of NAV</u>: To be done on an annual basis.
<u>Skin in the game</u>: The FME shall ensure that under a venture capital scheme it shall invest at least, lower of 2.5% of the corpus of the scheme or USD 750,000.

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Proposed Regulation	Explanation / Analysis
	▪ **<u>Benefits of relocation:</u>** The contribution by the FME shall not be mandatory in case of relocation of funds /schemes established or incorporated or registered outside India to IFSC. ▪ **<u>Exemption from contribution</u>:** (i) If at least 2/3rd of the investors in the scheme by value permits waiver of such contribution; (ii) at least 2/3rd of the investors in the scheme are accredited investors; (iii) The scheme is a fund of fund scheme investing in a scheme which has similar such requirements. ▪ ***<u>Co-investment</u>***: Co-investment in permissible investment through a SPV under a framework specified by the IFSCA or through a segregated portfolio by issuing a separate class of units.
Schemes for Fund Management | Retail Schemes	Retail Schemes, construed as mutual fund or mutual fund schemes, are schemes that can be launched by Registered FMEs (Retail) for pooling money from retail investors through an offer document for investment as per its stated investment objective in various permissible investments. Such schemes may be open ended or close ended. ▪ ***<u>Eligible Investors</u>***: Retail schemes shall have at least 20 investors with no single investor investing more than 25% in a scheme. ▪ ***<u>Investment Restrictions</u>*** *inter alia* include: (a) <u>Open ended schemes</u>: maximum investment in unlisted securities should not exceed 15% of the total AUM of the schemes. (b) <u>Close ended schemes investing more than 15% in unlisted securities</u>: minimum amount of investment by an investor shall be USD 10,000. (c) Retail schemes shall not invest more than 10% of its AUM in securities of a single company. (d) The minimum size of the retail schemes shall be USD 5 Million. ▪ ***<u>Skin in the game</u>***: The FME shall ensure that under a restricted scheme it shall invest at least, lower of 1% of the AUM of the scheme or USD 200,000.
Schemes for Fund Management | Special Situation Funds (SSF)	***<u>Permissible Investment</u>***: SSF means a scheme that invests in special situation assets which *inter alia* include: ▪ stressed loan available for acquisition in terms of Clause 58 of Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021; ▪ security receipts issued by an Asset Reconstruction Company registered with the Reserve Bank of India; ▪ certain specific securities of investee companies. ***<u>Nature of Scheme</u>***: Close ended with a minimum tenure of 3 years. ***<u>Borrowing</u>***: An SSF shall not borrow or engage in any leveraging activities other than to meet day-to-day operational requirements.

Proposed Regulation	Explanation / Analysis
Exchange Traded Funds (ETFs)	The Draft Fund Management Regulations provide for governing structures for ETF schemes including Equity Index based ETFs, Debt Index based ETFs, Commodity based ETFs, Hybrid ETFs (investing in 2 or more asset class), Actively Managed ETF, and gold and silver ETFs.
Focus on Environment Social Governance (ESG)	A FME managing AUM above USD 1 billion as at the close of a financial year or as may be specified by the IFSCA, shall establish policy on governance around material sustainability-related risks and opportunities. Such FMEs shall also disclose in its annual report how the FME identifies, assesses and manages material sustainability-related risks.
Other Fund Management Services	***<u>Portfolio Management Services:</u>*** FME in its capacity as a portfolio manager may have the following categories as clients: (a) a person resident outside India; (b) a non-resident Indian; (c) a non-individual resident in India who is eligible under FEMA to invest funds offshore; and (d) an individual resident in India who is eligible under FEMA to invest funds offshore, to the extent allowed. Further, the Draft Fund Management Regulations provide for norms related to disclosures, reporting, investment restrictions and other general obligations of portfolio managers. ***<u>Investment Advisory by a FME:</u>*** A FME as part of its portfolio management services enter into an agreement for advisory services subject to such other conditions/ relaxations, as may be prescribed. A FME may also provide services to multi-family office under a portfolio management agreement in the prescribed manner. ***<u>Investment Trusts:</u>*** Considering the similarities in activities of REITs and InvITs and their asset classes, the Draft Fund Management Regulations provide for a consolidated regulatory framework for both trusts. In case of private placement, any Registered FME may act as Investment Manager to such Investment Trusts. In case of a public issues, a registered FME (Retail) shall only be eligible to be appointed as an Investment Manager.
Listing of schemes/ units of FMEs	▪ ***<u>Listing of open-ended schemes</u>***: May be listed by FMEs at their discretion on recognized stock exchanges in IFSC. ▪ ***<u>Listing of close ended schemes</u>***: May be listed by FMEs at their discretion on recognized stock exchanges in IFSC. However, a close ended retail scheme shall be mandatorily listed on one of the recognised stock exchanges. ▪ ***<u>Listing of ETFs</u>***: Units of ETFs to be mandatorily listed on at least one of the recognised stock exchanges. ▪ ***<u>Listing of Investment Trusts</u>***: Units of Investment Trust (except for private placement of Investment Trust whose units are neither listed nor proposed to be listed on a stock exchange) shall be listed on a stock exchange within defined timelines. The Draft Fund Management Regulations also provide for conditions of delisting of ETFs or Investment Trusts or schemes by stock exchanges.

Proposed Regulation	Explanation / Analysis
General Obligations and Responsibilities	▪ Every FME, its fiduciaries, KMPs shall abide by the Code of Conduct. ▪ Maintain proper books of account, records and other document. ▪ Maintain a business continuity plan identifying procedures relating to an emergency or significant business disruption. ▪ Have a robust cyber security and cyber resilience framework in place. ▪ Have a sound risk management system for comprehensively managing all risks. ▪ Prior approval of the IFSCA required in case of any direct or indirect change in control of the FME. ▪ Constitution of an Investment Committee to make investment decisions for the schemes. ▪ Merger/ demerger/ restructuring of schemes permissible, subject to the guidelines as may be issued by the IFSCA. ▪ Appointment of an independent custodian to carry out the custodial services for certain schemes. ▪ Full redemption of a close ended scheme at the end of maturity period.

The consultation paper dated February 7, 2022 containing the Draft Fund Management Regulations (available here) has invited public comments till **February 28, 2022**.

B. Amendment to the master circular on scheme of arrangement by listed entities

SEBI had notified changes to the Master Circular on dated December 22, 2020 (**Master Circular**) on the scheme of arrangement by listed entities pursuant to circular dated November 16, 2021 (available here) and circular dated November 18, 2021 (available here). The aforementioned circulars inserted Para A (2) (k) to Part I of the Master Circular requiring listed entities to submit a NOC before the scheme of arrangement is submitted for sanction by the National Company Law Tribunal. In respect of the same, SEBI has clarified that the NOC must be obtained from lending scheduled commercial banks/ financial institutions/ debenture trustees, from not less than 75% of the secured creditors in value.

The Master Circular has been amended vide circular dated February 1, 2022 (available here) and shall be applicable for all the schemes filed with the stock exchanges **after November 16, 2021**

We trust you will find this an interesting read. For any queries or comments on this update, please feel free to contact us at insights@elp-in.com or write to our authors:

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