

InvIT and REIT Regulations: Recent Amendments

INTRODUCTION

The Securities and Exchange Board of India (“SEBI”) issued amendments on February 14, 2023, to the Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014 (“**InvIT Regulations**”) and the Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 (“**REIT Regulations**”). These are primarily governance-related requirements and apply to all infrastructure investment trusts (“**InvITs**”) and real estate investment trusts (“**REITs**”), including those planning a listing.

Some of the amendments are effective immediately and others with effect from April 1, 2023. Those effective immediately relate to: (i) the appointment and re-appointment of auditors, the requirement to undertake a limited review of the entities whose accounts are consolidated with the InvIT or REIT; (ii) provisions for the treatment of unclaimed or unpaid distributions; and (iii) a clarification to the calculation of leverage thresholds for consolidated borrowings and deferred payments, with cash and cash equivalents being excluded from the value of the assets of the InvIT or REIT (and overnight mutual funds having maturity of one day included as cash and cash equivalents).

The amendments that are effective from April 1, 2023, relate to: (i) a clarification to the definition of change in control; and (ii) obligations and governance requirements of the investment manager of the InvIT/REIT. Certain governance requirements, generally applicable to companies in India with listed equity shares, have been made applicable to InvITs and REITs, such as eligibility of an independent director, the requirement of a woman independent director on the board of the investment manager, the quorum for a board meeting to include an independent director, minimum information required to be placed before the board, establishing a vigil mechanism (including a whistle blower policy), constituting an audit committee, nomination and remuneration committee, risk management committee and stakeholders relationship committee and submission of compliance certificates, including by the chief executive officer and chief financial officer.

While InvITs and REITs may have been following certain of these requirements, including because they had outstanding non-convertible debentures exceeding a prescribed value

listed on a recognized stock exchange in India and were 'high value debt listed entities', each InvIT or REIT needs to examine the new requirements. Clarity may be needed for existing unlisted InvITs with respect to the governance requirements that become applicable to such entities from April 1, 2023.

OVERVIEW OF THE AMENDMENTS

Governance norms

These are effective from April 1, 2023.

Certain provisions of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**LODR Regulations**") have been made applicable to InvITs and REITs. Also, unless the context otherwise implies, certain terms under the LODR Regulations would be interpreted under the InvIT Regulations and the REIT Regulations as follows: (i) "promoter" as "parties to the InvIT/REIT", (ii) "listed entity" as the InvIT or the investment manager (in case of InvITs) and the manager (in case of REITs), (iii) "company secretary" as "compliance officer", (iv) "executive director" as "non-independent director", (v) "non-executive director" as "independent director", (vi) "board of directors of the listed entity" as "board of directors of the investment manager" and (vii) "subsidiary of the listed entity" as holding companies ("**HoldCos**") and special purpose vehicles ("**SPVs**") held by the InvIT or REIT.

Independent directors

- **Eligibility:** A definition of independent directors has been included in the InvIT Regulations and REIT Regulations. While the definition is based on the LODR Regulations, that apply to companies with listed equity shares and certain other listed securities, there are certain differences, including testing the definition of a related party based on a relationship with the "parties to the InvIT/REIT" (which comprise the sponsors, investment manager, trustee, sponsor group (for a REIT) and project manager (for an InvIT)), as well as the HoldCos and the SPVs, and its/their holding company, subsidiary and associate and their promoters and directors. References in the definition to the relationship of certain entities (e.g., holding companies, subsidiaries, associates) to the InvIT/REIT or the parties to the InvIT/REIT are not entirely clear and may need clarification.
- **Appointment:** The appointment, removal or reappointment of independent directors requires the approval of the shareholders of the investment manager (and does not appear to require the approval of the unitholders).

Under the LODR Regulations, listed companies are permitted to appoint a new independent director within three months of the date of vacancy if an independent director resigns or is removed from the board. The three-month forbearance has not

been made applicable for InvITs and REITs. However, the investment manager is required to ensure that at least 50% of its board is independent on a continuous basis.

- [Tenure](#): The maximum tenure of independent directors will be in accordance with the Companies Act, 2013 and the rules made thereunder. This is a five-year term, which can be extended by another five years, and a three-year cooling-off period is applicable thereafter.
- [D&O insurance](#): Directors and officers insurance, in such amount as determined by the board of the investment manager, is required to be obtained for the independent directors.
- [Cooling-off period for subsequent appointments](#): An independent director that resigns from the board of the investment manager is not permitted to be appointed as a non-independent director on the board of the investment manager or its holding, subsidiary or associate company or on the board of a company belonging to its promoter group, unless a period of one year has lapsed from the date of resignation as an independent director.
- [Others](#): Requirements with respect to meetings of independent directors, evaluation of the performance of non-independent directors, limitations on liability, familiarization programs and submission of declarations of independence have also been introduced.

[Board of Directors](#)

The current regulations require at least 50% of the board of directors of an investment manager to be independent and not be directors or members of the governing board of the investment manager of another InvIT or REIT, as applicable. The amendments introduce the following additional provisions:

- [Board composition](#): The board of the investment manager is required to comprise at least six directors, with at least one woman independent director.
- [Quorum](#): The quorum for every board meeting is the higher of one-third of the total strength of the board or three directors. It is required to include at least one independent director. Participation by video-conferencing or other audio-visual means will be counted for purposes of the quorum.
- [Minimum information to be placed before the board](#): Certain minimum information is required to be placed before the board. This includes the annual operating plan, budgets and any updates, capital budget and updates, quarterly results for the investment manager and its operating divisions or business segments, minutes of the audit committee and other committees, information on recruitment and remuneration of senior officers below the level of the board (including the appointment or removal of

the chief financial officer and the compliance officer), sale of investments, HoldCos, SPVs or assets that are material in nature and not in the normal course of business, material defaults in financial obligations to and by the InvIT/REIT, its HoldCos and SPVs, quarterly details of foreign exchange exposures and steps taken by management to limit the risk of adverse exchange rate movement, if material, any show cause, demand, prosecution and penalty notice which is materially important, any fatal or serious accident, dangerous occurrence and any material effluent or pollution problem, significant labor problems and their solutions and non-compliance with any regulatory, statutory or listing requirement and unitholder service such as non-payment of distributions.

- [*Minimum number of meetings:*](#) The board is required to meet at least four times a year with a maximum time gap of 120 days between any two meetings.
- [*Others:*](#) The investment manager is required to institute plans for orderly succession, formulate a code of conduct for all members of the board and senior management and adopt and implement procedures and policies to inform the board about risk assessment and minimization procedures and a risk management plan. Members of the board and senior management are required to confirm compliance with the code of conduct on an annual basis. Provisions for evaluation of independent directors by the entire board have also been introduced.

Also, the board is required to clearly set forth its recommendation in the unitholder notice for matters that require higher threshold approval under the InvIT Regulations and the REIT Regulations, *i.e.*, where the votes cast in favor of the resolution are not less than one-and-a-half times the votes cast against the resolution. These include matters relating to the removal, change or change in control of the investment manager, material changes in investment strategy or changes in management fees, delisting of units and matters that are not in the ordinary course of business which require unitholder approval.

Committees of the Board

The investment manager is required to constitute an audit committee, a nomination and remuneration committee, a stakeholders relationship committee and a risk management committee, as set out below.

- [*Audit committee:*](#) The audit committee is required to have at least three directors as members, with at least two-thirds being independent directors. The chairperson is required to be an independent director. All members must be financially literate and at least one member should have accounting or related financial management expertise.

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- [*Nomination and remuneration committee*](#): Under the LODR Regulations, the nomination and remuneration committee is required to comprise at least three directors with at least two-thirds being independent directors. Also, all the directors on the committee are required to be non-executive. The chairperson is required to be an independent director. The amendments to the InvIT Regulations and the REIT Regulations state that references in the LODR Regulations to “non-executive directors” are to be read as “independent directors”. Accordingly, as currently drafted, it appears that the nomination and remuneration committee of an investment manager can comprise of only independent directors. Non-independent directors, even if they are non-executive, are not permitted on such committee (clarity may be required in this regard).
 - [*Stakeholders relationship committee*](#): The stakeholders relationship committee is required to have at least three directors, with at least one independent director. The chairperson of the committee is required to be a non-executive director. As discussed above for the nomination and remuneration committee, clarity may be required on whether the chairperson is required to be an independent director (or whether a non-executive director is sufficient).
 - [*Risk management committee*](#): The risk management committee is required to have at least three members, with a majority being members of the board, including at least one independent director. The chairperson is required to be a member of the board and senior executives of the investment manager may become members of the committee.

Requirements for quorum, minimum number of meetings, terms of reference and information to be reviewed by the above committees are also prescribed.

Obligations with respect to directors, senior management and key managerial personnel

There are two different terms to consider when analyzing the regulations – key managerial personnel and senior management (the latter has been recently introduced). The term “senior management” has been defined to mean the officers and personnel of the investment manager who are members of its core management team (excluding the board of directors), and includes the company secretary, the chief financial officer and all members of management that are one level below the chief executive officer, the managing director, whole-time director or manager (and includes the chief executive officer and manager to the extent they are not already included). The term “key managerial personnel” has a different and slightly narrower definition under the Companies Act, 2013, and comprises the chief executive officer/managing director/manager, any whole-time director, the chief financial officer, company secretary

and an officer not more than one level below the directors who is in whole-time employment and who has been designated by the board as a key managerial personnel.

Certain obligations in relation to directors, senior management and key managerial personnel are discussed below.

- [*Maximum directorships*](#): For listed companies, under the LODR Regulations, a director can be a member of a maximum of 10 committees or act as a chairperson in a maximum of five committees across all such listed entities, subject to certain exceptions. However, based on the agenda of the SEBI board meeting held to approve the InvIT/REIT amendments, it appears these limits are not applicable to the directors of an investment manager of an InvIT or REIT. These directors are required to inform the investment manager about the committee positions they occupy in other listed entities and notify changes as and when they take place.
- [*Compensation or profit-sharing arrangements*](#): Under Regulation 26 of the LODR Regulations, which has been made applicable to InvITs and REITs, the members of the senior management are required to disclose all material, financial and commercial transactions where they may have a personal interest that may have a potential conflict with the interest of the “listed entity” at large. Conflict of interest relates to dealing in the shares of the “listed entity”, and commercial dealings with bodies which have shareholding of management and their relatives.

Further, based on Regulation 26 of the LODR Regulations as applicable to an InvIT or REIT, no employee (including key managerial personnel) or director of the investment manager or any of the parties to the InvIT/REIT, is permitted to enter into any agreement for itself or on behalf of any other person with any shareholder or any other third party with regard to compensation or profit sharing in connection with dealings in the securities of the “listed entity”, unless prior approval of the board and the public shareholders has been obtained by way of an ordinary resolution. There are also board and shareholder approval requirements, disclosure requirements and restrictions on interested persons in relation to existing and expired arrangements under these regulations.

There is some clarity required under the amendments. For example, the term “listed entity” has been replaced with the terms “investment manager and the InvIT, as applicable” under the new InvIT Regulations, but it includes only the manager and not the REIT under the REIT Regulations. Therefore, whether the securities of the REIT (e.g., its units) are covered will need to be clarified. References to public shareholder approval may also require clarity.

Additional compliance requirements

Requirements in relation to secretarial audit, submission of compliance certificates and corporate governance reports have been introduced, as set out below:

- [Quarterly compliance report](#): The board is required to review compliance reports every quarter relating to laws applicable to InvITs and REITs and steps taken to rectify instances of non-compliance. This is in addition to the existing requirement to review quarterly reports on the activity and performance of the InvIT or REIT.
- [Quarterly corporate governance report](#): A corporate governance report in the specified format is required to be submitted to the stock exchanges on a quarterly basis, within 21 days of the end of the quarter. The report is required to be signed by the compliance officer or the chief executive officer.
- [Secretarial compliance report](#): A secretarial compliance report issued by a practicing company secretary in specified format is required to be submitted to the stock exchanges on an annual basis, within 60 days of the end of the financial year. This report is required to be annexed to the annual report of the InvIT/REIT.
- [Compliance certificate](#): The chief executive officer, chief financial officer and compliance officer are required to submit a compliance certificate to the board of the investment manager in relation to the financial statements of the InvIT or the REIT and internal controls. The format of this certificate is similar to the format prescribed for listed companies under the LODR Regulations.
- [Vigil mechanism and whistleblower policy](#): The investment manager is required to formulate a vigil mechanism to provide safeguards against victimization of employees, including a whistleblower policy. The functioning of the vigil mechanism is required to be reviewed by the audit committee. The investment manager is permitted to engage an independent service provider for providing or operating the vigil mechanism.

Changes to the definition of “change in control”

This change will be effective from April 1, 2023.

Under the current regulations, the definition of ‘change in control’ under the InvIT Regulations and the REIT Regulations in relation to bodies corporate (which includes a company) refers to the definition of control under the Companies Act, 2013. For entities other than bodies corporate, this definition refers to a change in the ‘controlling interest’ of the entity, with ‘controlling interest’ defined as a direct or indirect interest to the extent of more than 50% of voting rights or interest in such entity.

Pursuant to the amendments, 'control' for bodies corporate whose shares are listed on any recognized stock exchange is to be construed with reference to regulations framed under the SEBI takeover regulations. For unlisted bodies corporate, control continues to refer to the definition under the Companies Act, 2013. For entities other than bodies corporate, change in control now includes change in 'legal formation' or ownership, in addition to a change in controlling interest.

Limited review of HoldCo/SPV accounts and appointment of auditors

Pursuant to the amendments, the statutory auditor is required to undertake a limited review of the accounts of all entities whose accounts are consolidated with the accounts of the InvIT or the REIT, in accordance with applicable accounting standards. While this provision is similar to the corresponding provision applicable to listed companies under the LODR Regulations, under those regulations the SEBI has also issued detailed procedures and formats for such review and specifically clarified for listed companies that the audit and limited review of components that are consolidated with the parent company will be undertaken by the respective auditors of such components. Accordingly, a similar clarification may be required under the InvIT Regulations and the REIT Regulations.

The amendments have also clarified that the investment manager may appoint an individual or firm as the statutory auditor who will hold office from the date of the unitholder meeting where the auditor is appointed until the conclusion of the sixth unitholder meeting thereafter. The investment manager is not permitted to appoint or re-appoint as the auditor (i) an individual, for more than one term of five consecutive years; and (ii) an audit firm, for more than two terms of five consecutive years. Further, a cooling-off period of five years has been prescribed for auditors that have completed their term for re-appointment as auditors in the same InvIT or REIT.

These provisions are in effect from the date of the amendment.

Clarifications for calculation of leverage thresholds

Under the regulations, consolidated borrowings and deferred payments, net of cash and cash equivalents, are not permitted to exceed prescribed percentages of the value of the InvIT/REIT assets (70% for InvITs and 49% for REITs, subject to certain conditions). For purposes of calculation of these thresholds, the amendments clarify that (i) overnight mutual funds, characterized by their investments in overnight securities and having maturity of one day, will be considered cash and cash equivalents; and (ii) the amounts of cash and cash equivalents is required to be excluded from the calculation of the value of the InvIT/REIT assets.

These provisions are in effect from the date of the amendment.

Treatment of unclaimed or unpaid distributions

The InvIT Regulations and the REIT Regulations did not provide for the treatment of unclaimed or unpaid distribution amounts. Pursuant to the amendments, amounts remaining unclaimed or unpaid out of distributions declared by InvITs or REITs are required to be transferred to the Investor Protection and Education Fund constituted by the SEBI, in such manner as may be specified by the SEBI.

These provisions are in effect from the date of the amendment.

CONCLUSION

The InvIT Regulations and the REIT Regulations historically followed a lighter touch approach to regulation, including with respect to governance norms. However, with the reduction in minimum investment, trading lots and increased retail participation, increased governance requirements are being introduced for InvITs and REITs.

In the past, there has been ambiguity with respect to the applicability of the LODR Regulations and additional compliances for InvITs and REITs that were high value debt listed entities. These amendments clarify this issue. However, certain additional clarifications may be needed from the SEBI on the recent amendments, as discussed above. All InvITs and REITs (including those proposing to register or list) need to review the new amendments. Clarity may also be needed for existing unlisted InvITs with respect to the governance requirements that become applicable to such entities.

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