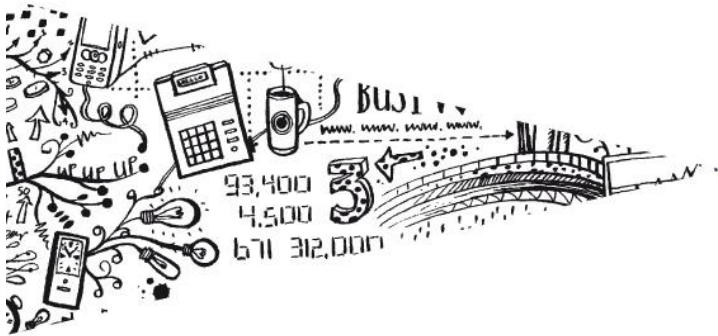


24 November 2011

# EY Regulatory Alert

Guidelines for Banks to sponsor/ set-up Infrastructure Debt Funds (IDF) in India and foreign investment in IDF units/ bonds



## Background

In order to accelerate and enhance the flow of long term debt to the infrastructure sector in India, the Finance Minister of India, Mr Pranab Mukherjee, during the Budget 2011-2012 speech had announced the creation of special vehicles in the form of notified Infrastructure Debt Funds (IDF), to attract foreign funds for infrastructure financing.

Since then the Government of India has issued a press release outlining the broad framework for IDFs following which the Securities & Exchange Board of India (SEBI) and Reserve Bank of India (RBI) have issued notifications providing further details of the enabling framework. For further details please refer to our alerts dated 14 September 2011 and 29 September 2011.

The RBI has on 21 November 2011 issued further guidelines for banks to sponsor IDFs. Further, by a notification of the same date, the RBI has notified the Infrastructure Debt Fund - Non-Banking Financial Companies (Reserve Bank) Directions, 2011 which formalises the framework for launch of IDFs as a Non-Banking Finance Company (NBFC). The RBI has also issued a circular dated 22 November 2011 permitting investment by eligible non-resident investors in IDFs set-up as NBFCs (IDF-NBFCs) and IDFs set-up as MFs (IDF-MFs).

This alert summarizes the key aspects of the circulars and notification released by the RBI on 21 November 2011 and 22 November 2011.

## Banks sponsoring IDF-MFs and IDF-NBFCs

In order to act as sponsors to IDFs to be set-up as mutual funds, banks are required to obtain prior approval of the RBI in addition to adhering to the conditions prescribed by SEBI.

Banks acting as sponsors to IDF-NBFCs will have to hold equity stake of 30% (minimum) to 49% (maximum) of the IDF-NBFC. Given that banks cannot hold more than 30% of the paid-up share capital of a company<sup>1</sup>, RBI would recommend to the Government of India to allow banks to have investment in excess of 30% in the equity of IDF-NBFC. Banks that fulfill the eligibility criteria are required to make an application to the Department of Banking Operations and Development to sponsor IDF-MFs and IDF-NBFCs.

### *General conditions for banks acting as sponsors to IDFs*

- ▶ Investment in the equity of a single IDF should not exceed 10% of the bank's paid up share capital and reserves
- ▶ Investment in IDFs would be included within the limit of 20% of the bank's paid up share capital and reserves in respect investments in subsidiaries, financial services companies, financial institutions, stock and other exchanges put together

<sup>1</sup> Section 19(2) of the Banking Regulation Act, 1949

- ▶ Contribution to IDFs as sponsors will form part of the banks' capital market exposure and should be within the regulatory limits specified in this regard
- ▶ Policies and limits for overall infrastructure exposure including exposure to sponsor IDFs should be laid down by the Board of banks
- ▶ Prospectus/ offer document issued by IDFs for inviting investments should disclose that the bank's liability is limited to the extent of its contribution to the paid up capital of the IDF

## Foreign investment in IDFs

The RBI *vide* its circular dated 22 November 2011 has made amendments to the regulations for transfer or issue of security to a non-resident outside India. The amendment *inter alia* allows investment on repatriation basis by eligible non-resident investors in foreign currency and Rupee denominated bonds issued by IDF-NBFCs and Rupee denominated units issued by IDF-MFs. The salient features of the circular are as follows:

### *Eligible non-resident investors*

- ▶ Sovereign wealth funds, multilateral agencies, pension funds, insurance funds, endowment funds and High Net worth Individuals (HNIs)

registered with SEBI as eligible non-resident investors in IDFs (eligible non-resident investors in IDFs)

- ▶ SEBI registered Foreign Institutional Investors (FIIs) and HNIs registered as sub-accounts of FIIs
- ▶ Non-resident investors (NRIs) being Indian citizens or persons of Indian origin and resident outside India

*Investment conditions*

- ▶ Original initial maturity of eligible investments at the time of first investment to be five years with minimum-lock in period of three years
- ▶ Non-resident investors can trade amongst themselves within the lock-in period
- ▶ Existing regulations in respect of External Commercial Borrowings apply to foreign currency denominated bonds issued by IDFs

Special Purpose Vehicles across all infrastructure sectors, project stages and types

- ▶ Facility of foreign exchange hedging in respect of foreign exchange/ currency risk available to non-resident IDF investors, IDFs as well as the infrastructure project companies

*Eligible instruments/ securities*

Eligible Security	Eligible investors
<i>Foreign currency and Rupee denominated bonds and Rupee denominated units issued by IDFs</i>	Eligible non-resident investors in IDFs
	SEBI registered FIIs qualifying as eligible non-resident investors in IDFs and HNIs registered as sub-accounts of FIIs
<i>Rupee denominated bonds and units issued by IDFs</i>	SEBI registered FIIs (other than eligible non-resident investors in IDF)
	NRIs

*Investment Limits*

- ▶ No cap on investments by NRIs
- ▶ A cap of USD 10 billion has been specified for investment in IDFs. This cap is within the present overall cap of USD 25 billion for FII investment in Indian companies in infrastructure sector (infrastructure defined as per the current guidelines for External Commercial Borrowings) and Infrastructure Finance Companies

*Other conditions*

- ▶ IDF-NBFCs to invest only in debt securities of Public Private Partnership infrastructure projects with buyout guarantee and completion of at least one year of commercial operations - refinance upto 85% of total debt covered by the concession agreement
- ▶ IDF-MFs to invest minimum 90% of its funds in debt securities of infrastructure companies or

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