Report of the Expert Committee on feasibility of the Variable Capital Company in International Financial Services Centres in India

Variable Capital Companies in IFSC

26 May 2021

Shri Injeti Srinivas,
Chairman,
International Financial Services Centres Authority

Dear Sir,

The International Financial Services Centres Authority, by its Office Order dated 22nd September 2020, constituted an Expert Committee to examine the relevance and adaptability of the Variable Capital Company (VCC) in the International Financial Services Centre (IFSC) in India.

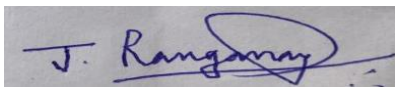
We thank you for the opportunity given to us and humbly submit herewith the final report providing key recommendations for the adaptability of VCC in the IFSC in India.

Yours sincerely,

Shri K P Krishnan, Chairperson

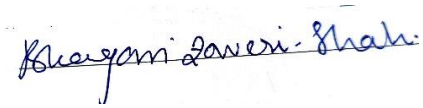
Shri Ketan Dalal, Member

Shri Tushar Sachade, Member



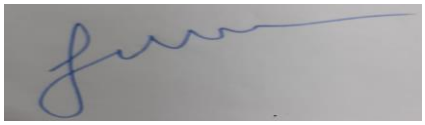
Shri J Ranganayakulu, Member

Shri Bobby Parikh, Member

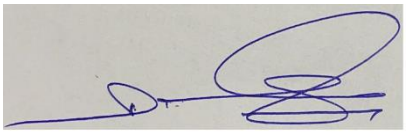


Ms. Bhargavi Zaveri-Shah, Co-opted Member

Shri Pranay Chaturvedi, Member



Shri Jithesh John, Co-opted Member



Shri Denning K Babu, Member Secretary

1. Preface

In September 2020, the International Financial Services Centres Authority ('the IFSCA') constituted a Committee of Experts ('the Committee') to examine the feasibility of the Variable Capital Company ('VCC') in India. I was delighted when the IFSCA Chairperson, Shri Injeti Srinivas asked me to chair this Committee.

My memory went back to 2007 when I, as Joint Secretary (Capital Markets), Government of India, was asked to be the Convenor of the High-Powered Expert Committee ('HPEC') on 'Making Mumbai an International Financial Centre'. Some of the recommendations made in that report are still relevant and it is heartening to see that India's dream of having an International Financial Services Centre ('IFSC') is taking shape. Although, at first sight, it may seem that a different city is becoming an IFSC and that too after a decade, in truth, the HPEC report was (and is) about India becoming a provider of international financial services. The Budget announcement for the year 2005-06 that led to the HPEC, had mentioned Mumbai. The argument was that being the current financial centre of the country, it was logical to think of Mumbai as an IFSC. Neither the HPEC nor the recent International Financial Services Centres Authority Act, 2019 ('IFSCA Act') restricts the provision of international financial services to any one centre or city. As the centre most ready to carry forward the dream, it is therefore equally logical to implement the idea in Gandhinagar. As to the ten years lapse, it is good to remember that reforms that require far reaching legislative changes need social and political consensus besides the views of experts. With the current pace of implementation of the idea, it is certainly more than making up for lost time.

Fund management activities are an important pillar of the overall financial services ecosystem. In line with the mandate given to the Committee, it examined the relevance and adaptability of the VCC for the IFSC in India or alternative structures to attract fund business in the IFSC. The overarching principle of the Committee has been to recommend a simplified structure which would embrace the advantages of the current trust and corporate structure and address their limitations. The Committee was also conscious of the fact that the success of VCC

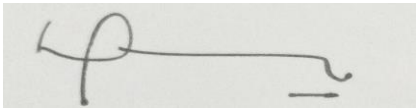
in the IFSC is dependent on the success of the IFSC and therefore chose to include a Chapter on 'Crucial elements for success of the IFSC' in this report.

In its first meeting on 28 September 2020, the Committee co-opted Shri Jithesh John, Adviser in the Department of Economic Affairs and Ms. Bhargavi Zaveri-Shah from Finance Research Group, as additional members. I am thankful to them for having readily accepted the offer.

The Committee conducted various meetings both in-person and electronically over the last few months to discuss in detail the various aspects related to VCC structure and its relevance in the Indian context. The Committee also invited subject matter experts to understand the nuances associated with the VCC structure and seek a global perspective on the structure.

I take the opportunity to thank all my fellow Committee Members for their valuable time, support and contributions over the past few months which has culminated in the form of this report.

This report is a modest and sincere attempt to support the IFSCA's vision to develop the IFSC as a preferred global hub for international financial services.



K P Krishnan,
Chairperson, Committee of Experts for Feasibility of the Variable Capital Company in India

2. Acknowledgements

The Committee would like to place on record its sincere thanks to the following subject matter experts for sharing their insights on the VCC regime and its relevance for the asset management industry over a video call on 28 October 2020.

Expert	**Organisation**
Shri Armin Choksey	Partner, Asian Investment Fund & Market Research Centre Leader, PwC Singapore
Shri Manish Khandelwal	Director, Products and Operations, UTI International Singapore Pte Ltd
Shri Vidhu Shekar	Country Head, India, CFA Institute
Shri Sivananth Ramachandran	Director, Capital Markets Policy, India, CFA Institute
Shri Aditya Sesh	Founder & MD, Basiz Fund Services

The Committee also wishes to express its appreciation to Shri Manoj Kumar, Executive Director, IFSCA who helped to arrange the Committee meetings at SEBI Bhavan, Mumbai with due caution and care amidst the COVID -19 pandemic.

The Committee extends special thanks to Shri Denning Babu, Member Secretary, for the seamless co-ordination of the Committee meetings, finalizing the agenda and the minutes of the Committee meetings in a timely manner.

Finally, sincere thanks to Shri Suresh Swamy, Chartered Accountant, Ms. Vrushali Prabhu, Chartered Accountant, and Shri Vijay Morarka, Chartered Accountant, for extending their relentless support in diligently making notes, research and assisting the Committee with finalizing the report. Shri Tushar Sachade, an esteemed member of the Committee deserves a special word of appreciation from all of us in the Committee.

3. Executive Summary

IFSCs are intended to serve as gateways for Indian investments as well as hubs for global investments from India. The eco-system of financial services and products in IFSCs is to a large extent powered by a thriving asset management industry. A flexible regulatory framework at par with regulatory frameworks found in globally competitive financial hubs, such as London and Singapore, is critical to the success of the asset management industry in IFSCs.

Conventionally, pooling of funds in India is undertaken through three types of entities, namely, limited liability companies governed under the Companies Act, 2013; limited liability partnerships under the Limited Liability Partnership Act; and trusts governed under the Indian Trusts Act, 1882. Of these, trusts are found to be predominantly used to pool funds for a variety of reasons, ranging from historical factors to pragmatic considerations such as lower compliance costs and more confidentiality. These vehicles have their own set of advantages and constraints (Chapter 7). The IFSCA set up this Committee to explore the potential for allowing another legal structure – popularly known as a variable capital company (VCC) – as an additional option through which asset managers could pool the investors' funds. The VCC structure dispenses with some of the key limitations of companies and LLPs and provides for higher regulatory standards than those applicable to trusts.

The Committee assessed the features of a VCC or its equivalent, in other jurisdictions such as the UK, Singapore, Ireland and Luxembourg. The Committee recommended the adoption of a VCC-like legal structure for the purpose of conducting fund management activity in IFSCs (Chapter 8), while fully recognizing that the adoption of a VCC-like structuring will not, by itself, stimulate a thriving global asset management business in IFSCs (Chapter 5).

The Committee recognized the following elements as the desirable features of a legal framework governing entities that undertake fund management: (i) the need for certainty and clarity for investors; (ii) effective segregation and ring fencing of different pools of asset; the ability to issue different classes of shares; (iii) the ability

to distribute proceeds from the sale of investments; (iv) alterations to the funds' capital structure without regulatory approvals; (v) the freedom to choose the appropriate accounting standards applicable to funds with different characteristics; the ability to wind up quickly; (v) maintaining the confidentiality of investor information and keeping overall cost low. The Committee used these principles as the foundation for its recommendations on the legal framework governing VCCs in India.

The recommendations of the Committee on the design of the legal framework governing VCCs are summarized in the next few paragraphs (Chapter 10):

Incorporation of the VCC and sub-funds

a. VCC should have a separate legal identity from its shareholders, the capacity to enter into contracts and hold property, perpetual succession and the ability to sue and be sued in its own name. The share capital of the VCC should be variable in nature to allow for easy entry, redemption and buy-back of its shares by investors.
b. A VCC can have multiple sub-funds, which are like schemes of a mutual fund. Sub-funds should not be separately incorporated. The shares issued by the VCC will be linked to the assets and liabilities of a sub-fund. The VCC should issue a separate class of shares for each sub-fund. Akin to a mutual fund scheme, each sub-fund will issue a scheme document and the affairs of the sub-fund will be governed by this document.
c. The assets and liabilities should be segregated at the sub-fund level. The assets of any one sub-fund should not be used to discharge the liabilities of the VCC or any of its other sub-funds.
d. VCCs should be allowed to issue, redeem or buy back the securities issued by them, or undertake capital reduction exercises, without restrictions.

Payment of dividend, financial statements, etc.

e. VCCs should be allowed to pay dividends out of their capital as well as profits.
f. The financial statements of each sub-fund should be maintained separately. For privately traded sub-funds, financial statements should be made available

to the holders of shares linked to the specific sub-funds. The Right to Information Act, 2005 provides for certain exemption from disclosure of information, which includes information available to a person in his fiduciary relationship unless the competent authority is satisfied that the larger public interest warrants disclosure of such information. Similar to the above appropriate carve out, , may be provided to IFSCA/ Registrar of VCC who would be in possession of the financial statements of privately traded sub-funds.

Mergers, amalgamation, winding up, etc.

g. The merger / amalgamation of two or more sub-funds of a VCC may be undertaken with the approval of a majority of the investors of such sub-funds as may be specified in the scheme document. The merger/ amalgamation of two or more sub-funds or VCCs should not be a NCLT-led or a NCLT-supervised process, but a simpler process.
h. A VCC may be resolved and liquidated in accordance with the provisions of the IBC, subject to certain exceptions. In case of sub-fund of a VCC, the same may be wound up in accordance with the provisions of its scheme document. The IFSCA may prescribe additional conditions to be met by a VCC for winding up a publicly traded sub-fund.
i. Similar to section 67 of the LLP Act, 2008, a legal provision should empower the Central Government to notify any provision of the Companies Act, 2013 to VCCs with such exceptions, modifications and adaptation as may be specified in the notification.

Re-domiciliation and tax

j. To encourage foreign funds to migrate to the IFSC, the concept of re-domiciliation should be introduced in the IFSC. The IFSCA should initiate discussions with the Central Government in this regard to design an implementation roadmap.

k. From a tax perspective, each sub-fund should be deemed to be a separate 'person' and should obtain a separate PAN in its own name and all the provisions of Indian tax laws should apply to the sub-funds treating it as a separate person. Each sub-fund should file a separate tax return in India, disclosing its gains/ losses and taxes.

l. The merger and acquisitions of VCCs/sub-funds should be tax neutral irrespective of whether it is within the same VCC or between two separate VCCs.

The Committee deliberated whether the legal framework governing VCCs should be embodied in a separate law. The members unanimously recommended that VCCs, being a new corporate form in India, warranted a separate law to be introduced, containing the substantive provisions governing the VCC structure.

Finally, VCCs are essentially pooling vehicles for funds belonging to investors all over the world. For this reason, VCCs will be regulated by the IFSCA like any other financial intermediary in the IFSC. In particular, VCCs dealing with public funds may be subjected to higher governance thresholds than those specified in the legal framework governing the incorporation of VCCs. Accordingly, in addition to the requirements under a potential VCC law, the VCC would also be required to comply with the regulations set out by the IFSCA.

4. Introduction

The idea of an international financial services centre was first mooted in 2007 by the HPEC[1] on making Mumbai an International Financial Centre. HPEC articulated seven elements for establishing an international financial services centre in India that could compete globally and serve the Indian hinterland. India has since made progress with the formation of Gujarat International Finance Tec-city ('GIFT city') as an International Financial Services Centre ('IFSC') and the enactment of the International Financial Services Centres Authority Act, 2019 ('IFSCA Act').

A thriving asset management industry is critical for the success of the IFSC. In many ways, asset management is a business that powers all other financial services and products in the IFSC. The regulatory framework governing asset management is critical. This underscores the importance of the legal and regulatory framework governing the asset management business in the IFSC. An important element of the legal framework governing asset management is the flexibility of structures and vehicles that asset managers may use to house the asset management activity.

In India, a finite number of legal structures are available in the asset management industry. Until 2012, the trust was the only popular vehicle available for the pooling of funds. In 2012, Securities and Exchange Board of India ('SEBI') enacted the SEBI (Alternative Investment Funds) Regulations, 2012, which allowed funds to be pooled from private investors into a trust, company and limited liability partnership ('LLP'). These regulations did not apply to mutual funds or collective investment schemes. Retail funds could, thus, only be set up as trusts. For these reasons, 'trust' continues to be the most common vehicle for pooling large funds in India.

[1] Report of the High-Powered Expert Committee on Making Mumbai an International Financial Centre

Each of the three vehicles available in India for pooling funds has its own set of advantages and disadvantages. For example, the Companies Act, 2013 is often perceived to be over-prescriptive in matters of internal governance, winding up, management-shareholder relationships, which are not warranted for companies which are merely pooling vehicles. Also, the lengthy winding up provisions under the Companies Act, 2013 would be inappropriate for winding up a pooled fund. Similarly, the provisions relating to the reduction of paid-up capital and buy-back would be inappropriate for an open-ended fund. On the other hand, the Companies Act, 2013 does not cover issues that are critical to the management and governance of a Fund. For example, the segregation of assets and liabilities of different classes of investors, is alien to the concept of a company under the Companies Act, 2013. LLP structure for the pooling of funds would suffer from similar drawbacks.

As discussed above, trusts are the most commonly used pooling vehicles in India. However, they are perceived as a handicap from the perspective of claiming tax benefits under Double Taxation Avoidance Agreements ('DTAAs'). Secondly, private trusts are governed under the Indian Trusts Act, 1882. This law has largely evolved through jurisprudence. So far as mutual funds are concerned, the SEBI (Mutual Funds) Regulations, 1992 define the rights and duties of trustees and beneficiaries in detail. However, for other pooling vehicles, the usage of 'trusts' creates considerable uncertainty on these critical aspects. The limitations of these pooling structures are discussed in greater detail in Chapter 7 of this report.

The IFSCA has the objective of regulating and developing financial products and financial services in the IFSC. IFSCs are sought to be positioned not only as gateway for Indian investments but also as a hub for global investments. A thriving fund management industry comprising of local and foreign fund managers is critical to achieve this objective.

This underscores the need to ensure that Fund Managers seeking to set up pooling vehicles for investing in financial products traded in the IFSC are not

inhibited by the limitations of the available legal structures in India. It is therefore opportune to consider an alternative to the popular trust structure, which blends the advantageous features of trusts, companies and LLPs, and is globally recognised and accepted.

Toward this end, the IFSCA constituted this Expert Committee to examine the relevance and adaptability of Variable Capital Companies ('VCC') for IFSCs in India.

In this report, the Committee has evaluated the features of trusts, LLPs and company structures prevalent in the Indian asset management industry and the issues/ challenges that these structures pose from a flexibility, governance and taxation perspective. On the basis of the evaluation, the Committee has made its recommendation on both the need and the feasibility of introducing a VCC structure in IFSC in India. The Committee has also evaluated the legal provisions governing such a structure in globally competitive financial markets. The Committee has thereafter recommended practices considering the Indian legislative framework.

However, before dwelling on those aspects, it is necessary to emphasize that introduction of VCC as a structure, by itself, will be insufficient to attract Funds to the IFSC. To attract Funds and Fund Managers, the IFSCA must address several factors. The success of the fund management industry in IFSCs will hinge on those crucial factors as well rather than merely on the availability of a VCC structure. The Committee has taken the liberty to highlight some crucial elements for the success of the IFSC that various stakeholders must focus on simultaneously.

5. Crucial elements for success of the IFSC

The World Bank Group conducts an annual study[2] across 190 economies—from Afghanistan to Zimbabwe—investigating the regulations that enhance business activity and those that constrain it and ranks the countries on various parameters. India ranks 63rd in the ease of doing business in 2020, compared to Singapore and Hong Kong, which rank second and third in the list. Over the last couple of years, India has done well to improve its overall ranking; however, it still has some way to go to be amongst the top countries.

The IFSC has an opportunity to break away from this legacy and create a centre that could do better. The HPEC report emphasized the importance of a simple, clear and competitive legal regime, as a critical factor to the success of IFSCs in India. Among the seven elements it listed for the creation of successful IFSCs, it articulated the importance of a simplified legal regime as follows:

"A system of financial regime governance (i.e. embracing legislation, policies, rules, regulations, regulatory agencies etc.) that is amenable to operating on global 'best-practice' lines and standards"

The IFSCA should choose jurisdictions it would like to use as benchmarks. It is imperative for the IFSCA to get its benchmarks correct, right from the beginning. Businesses familiar with leading international financial centres will at least expect similar operating practices and procedures that prevail in those centres. Appropriate international benchmarking will also enable the IFSC to avoid the pitfall of 'reducing unease' as being equivalent to 'improving the ease' of doing business.

The laws in the IFSC should be 'principle based' rather than 'prescriptive and rules based'. The effort should be to ensure that the regulatory regime in the

[2] Doing business guide http://documents1.worldbank.org/curated/en/688761571934946384/pdf/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies.pdf

IFSC is at par with international standards on transparency, anti-money-laundering and international information-exchange agreements including Know Your Customer and Anti Money Laundering related requirements. In early 2021, the IFSCA became a member of International Organisation of Securities Commissions, which provides a platform to exchange information at global and regional level on common interest areas and to co-operate in enforcement. The membership of organisations of such international regulators will help the IFSCA to learn from the international experiences and adopt best practices of the other global financial centres.

The IFSCA is an unified regulator, with representation from the Reserve Bank of India ('RBI'), Securities and Exchange Board of India ('SEBI'), Insurance and Regulatory Development Authority ('IRDA'), Pension Fund and Regulatory and Development Authority ('PFRDA'), being the Indian mainland regulators and from the Government on its critical decision making bodies. To this extent, it will be able to achieve unification of the financial regulation of the kind that is seen in comparable jurisdictions. However, it is possible that there will be situations where the IFSC regulations will interplay with the Indian regulations, if market participants seek to carry some of their business activities from the Indian mainland. These transactions will be in the regulatory domain of the Indian mainland regulators. Appropriate inter-regulatory coordination between the IFSCA and these regulators is therefore equally important, such that any issues are promptly addressed, diametrically opposite views are not taken, and a regulatory quagmire is avoided.

Another critical element of the original vision of IFSCs was sophisticated Information and Communication Technology across operations, regulations and even physical infrastructure. Registration and renewals should be simple, online and paperless. Self-certified documents should be accepted and the requirement for external authentication should be kept at the minimum. The interactions with market participants should be through the web-based portal. Single window clearance should be the norm. Response to queries raised by market participants should be provided over emails in a quick time-bound

manner and transparency must be maintained over the affairs of the regulator. Stakeholders consultations should be welcomed. Up-to-date FAQs should be available for all key regulations on the IFSCA portal.

The IFSCA also plays a developmental role. In its developmental role, it should organise outreach programmes, seminars and webinars to socialise the IFSC in India through Indian Consulates in important cities and countries. Businesses across the world need to know about the existence of the IFSC in India before they even consider setting up any presence or undertaking any transaction here. Similar to practices adopted by the Regulators in leading Asia Pacific jurisdictions, the IFSCA should seek to separate its developmental role from the role of regulation and create appropriate firewalls between the two functions as they can potentially create conflicts.

Developing a robust ecosystem will be equally important. Banking, capital market, asset management, insurance companies, and pension funds form the core of the IFSC. The IFSCA regulations enabling Global In-house Centres and framework to enable legal, compliance and secretarial, trusteeship, asset management support services, auditing, accounting, etc is a step in the right direction to create conducive ecosystem in the IFSC. If people congregate daily at a place to work, it is natural for the other soft infrastructure such as hotels, restaurants, malls and multiplexes to come up. Employing these services will create a ripple effect on the ecosystem in and around the IFSC.

The availability of local talent will be crucial for companies to set up presence in any city. In consultation with the industry participants, the IFSCA should work with local universities and educational institutions and encourage them to devise courses that will be relevant to the financial service industry, and thus, be the source for long-term talent for companies set up in the IFSC, similar to Memorandum of Understandings recently signed by IFSCA with leading academic institutions.

Last but not the least, tax plays an important part in the overall decision-making process. The IFSCA should work with the Ministry of Finance to ensure that the tax regime for the IFSC is simple and straightforward. Withholding tax should be the final tax. Investors should not be required to obtain tax identification numbers or file tax returns if the entities set up in the IFSC have already withheld and paid full tax.

6. Features of a desirable Fund structure

Several legal and commercial considerations drive the selection of a fund vehicle. This Chapter considers some of the important features of a desirable fund structure.

A critical consideration for investors is **certainty and clarity.** Investors seek this across a range of parameters, whether it be the legal framework that governs the particular form of fund vehicle, the taxing provisions that would apply, or the limitation of liability. A stable, predictable and consistently administered legal framework provides investors reassurance – though this has broader connotations, these considerations are equally relevant while considering and choosing a particular form of fund vehicle. Similarly, investors seek clear, unambiguous taxing provisions applied with consistency; because a number of investors in Funds tend to be Funds themselves and such Funds invest in multiple jurisdictions, managing uncertain taxing outcomes across jurisdictions can be particularly challenging. Also, because Funds established in the IFSC may invest in India as well as in other jurisdictions, the taxability of the Fund's income in various jurisdictions may be influenced by the ability of the Fund to be taxed in accordance with a tax treaty that India has with the relevant jurisdiction; an entity which enables such taxation would be preferred. Clarity and certainty in the context of liability limitation is vital given that investors entrust their funds to investment managers and in most cases, have limited ability to influence the actions of the investment managers. Liability limitation could have multiple dimensions, but at a base level, investors would seek certainty with regard to both, caps on the absolute liability they may be exposed to as well as caps on duration beyond which claims on investors would be legally barred.

Regulations tend to influence a number of aspects of fund structure and operations which in turn drive choices exercised by investment managers and investors. Different investors may invest in different Funds or sub-funds with

different expectations; similarly, Funds may adopt different investment strategies and investors may wish to participate in a combination of some strategies and not in others. Where such an investing and operating framework is commercially necessary, the fund vehicle choice must enable the implementation of such a construct. From this perspective, a fund vehicle that enables **an effective segregation and ring-fencing of different pools of assets** and mapping each such pool to a particular set of investors would be preferred over other vehicle options that may not effectively enable such a segregation. Flexibility may also be required to segregate investors and managers based on differential participation in investments or in the share of income arising from investments made by a Fund. This is often effectively addressed through the issue of **different classes of fund interests** (e.g. different classes of shares or units) and a vehicle that permits this may be preferred over one that does not.

Funds differ from entity structures adopted for conventional commercial activities in certain important respects. It is common for Funds to have limited life; an ideal fund vehicle would be one which can be **wound up quickly, efficiently and with very limited compliance obligations**. Entry and exit barriers must be low. There should be no requirement to seek approvals from multiple regulators or from the Courts, for either setting up or winding up. A single window is welcome. For example, the Ministry of Corporate Affairs ('MCA'), through the SPICe+ form links ten services across three Central Government Ministries and Departments (Ministry of Corporate Affairs, Ministry of Labour & Department of Revenue in the Ministry of Finance) and one State Government (Maharashtra). Incorporation, Director Identification Number ('DIN') allotment, issue of Permanent Account Number ('PAN'), issue of Tax Deduction and Collection Account Number ('TAN'), Employees Provident Fund Organisation registration, Employees State Insurance registration, Profession Tax registration, bank account opening of the company, Goods and Service Tax Identification Number, is enabled through a single window.

Similarly, it is common for Funds to have provisions which would require a **distribution of proceeds** from the sale of investments held by the Fund. An ideal fund vehicle must freely permit such distributions as required under the Fund documents and without conditioning such distributions on compliance with accounting or other regulatory prescriptions (for e.g. the requirement for distributions to only be made from 'profits') which are more relevant for conventional commercial vehicles. Depending on the commercial terms of funds, investors may commit an investment amount to the Fund which may be drawn down in instalments over a period of time. The periodic draw down of amounts from investors and a distribution of proceeds by a Fund may often be accompanied by an **alteration to the Fund's capital structure**. An ideal fund vehicle would freely permit such alterations without subjecting such actions to regulatory requirements (eg rules for the issue and redemption, cancellation or the buy-back of securities, rules for issue of securities of different classes) which may be inappropriate in the context of fund entities. Regulations may contain prescriptions regarding accounting standards as well as the method of accounting that an entity must adopt. Given that investors in Funds in the IFSC will be international investors, and also given that the IFSC-based Funds may invest in Indian as well as in other jurisdictions, fund vehicles may benefit from flexibility in their **choice of accounting standards** and methods of accounting; vehicle choices would be influenced by the form of vehicle that provides greater flexibility. Regulations may also contain a range of **prescriptions around governance** – requirements for directors, trustees, company secretaries, custodians, board and shareholder meeting protocols. These prescriptions vary based on the nature of entity. The considerations underlying such prescriptions may not be entirely relevant for fund entities given the particular context in which they operate. For these reasons, entities which attract lighter governance obligations and permit greater flexibility in adopting disclosure and governance frameworks, would be preferred.

The **confidentiality of information** about the Fund's activities and its investor base is of paramount importance to the Fund Manager and potentially to many investors as well. Allowing third parties access to proprietary information such

as a list of investors participating in a Fund, would give competitors a free ride on the meticulous efforts of the Fund Manager to identify and market its Fund to its investors. Similarly, regulations which permit access to a Fund's financial statements could compromise the interests of the Fund Manager and also those of the Fund's investors. An ideal fund vehicle would be one which preserves the confidentiality of such commercially significant information and requires its disclosure only in limited circumstances.

Finally, the internationalization of finance has made the financial services industry extremely competitive and firms require conscious efforts to **keep costs low**. Umbrella and sub-funds structures enable firms to keep the cost of floating a new fund low. For instance, UK open-ended investment companies can act as an umbrella scheme holding various sub-funds, each with their own investment goals. The flexibility to set up each new fund as a sub-fund of the umbrella rather than establishing a new entity reduces the cost substantially and achieve economies of scale.

7. Current Fund structures in India and their challenges

Use of trusts in fund structures in India

The concept of 'Trust' is integral to the asset management industry. The mutual fund industry introduced it in the mid-1960s to attract small investors and introduce them to market investments. With the entry of private sector funds, Indian investors showed greater interest in mutual funds, thereby, creating a larger competitive landscape. This received further impetus with the entrance of foreign fund management companies into the mutual fund set-up; most of them entered through joint ventures with Indian promoters.

Subsequently, the private equity segment adopted the 'Trust' structure, promoting it in the Alternative Investment Fund industry. The trust structure has received legal backing through the SEBI (Mutual Fund) Regulations, 1995 and the SEBI (Alternative Investment Funds) Regulations, 2012. While the former mandates mutual funds to be set up as trusts, the latter permit privately pooled investment funds, to be set up as trusts, companies or LLPs.

In 2014, the Government of India extended the concept of business trust, which operate as Real Estate Investment Trusts ('REITs') and Infrastructure Investment Trusts ('InvITs'). REITs own and manage income generating developed properties and offer their units to public investors; they own many types of commercial real estate, from office and apartment buildings to warehouses, hospitals, shopping centres, hotels, etc. InvITs usually make direct investments in infrastructure facilities that yield income, e.g. toll roads, railways, inland waterways, airports, urban public transport. InvITs will allow infrastructure developers to monetise specific assets, helping them use proceeds to complete projects which have been stalled for want of funds.

There are several factors which have contributed to the popularity of the trust structures, including as under:

- Formation and registration

The creation of a trust is governed solely by the indenture of trust or trust deed, which is executed between the settlor and the trustees. Thus, the ease and low costs in setting up of a trust have made it a popular and reliable investment structure in the asset management industry. Unlike a company or an LLP (both under the purview of MCA), trusts are usually governed by state specific regulations. Registration of trust deeds and any amendment thereto is also simple and easy.

- Contributions

Unlike Indian companies, trusts do not have prescribed minimum capitalisation requirement. The Indian Trusts Act, 1882 permits trusts to receive contributions from time to time, from persons other than the original settlor. The terms of drawdown of funds and the distribution of income to its investors are not subject to restrictions under any regulations or laws, and the contributions can be received from the beneficiaries at any time. Additional funds can be raised by the fresh issuance of units. Accordingly, this structure is most popular in case of Mutual Funds and AIFs, wherein flexibility to raise and redeem capital is very critical.

- Taxation

For Indian income-tax purposes, trust is not regarded as a separate person, and the income of the trust is taxable in the hands of the trustees as a “representative assessee”. There are special provisions in the Income-tax Act, 1961 which subject the representative assessee to tax in the like manner and to the same extent as it would be leviable and recoverable from the person represented by him. Distributions by the trust to its beneficiaries is subject to single level tax compared to a company, where there is double taxation - one at the level of the company on its profits and second in the hands of the shareholders at the time of receipt of dividend.

- Liquidation

The liquidation procedure for a trust is also governed by its trust deed, with minimal statutory intervention. In contrast, several approvals are required in case of a company structure.

- Disclosure/ compliance requirements

The Trust Deed is not available in the public domain and confidentiality of the investors and the investments made therein can be respected. It also provides the flexibility of adding in multiple schemes under a single trust structure.

The level of disclosures and compliance formalities in a trust structure are relatively lower. There are no separate reporting obligations to regulators other than those mandated by the Mutual fund or AIF Regulations. The reporting to contributors would be as per the contribution agreement. However, a 'trust' is a common law concept and if given an option, investors from non-common law countries would not make it their default choice. There are certain limitations of the trust structure as well which are mentioned hereunder:

- Unlimited liability of the trustee

The trustee(s), being the legal owner(s) of the trust, has/have unlimited liability. Therefore, individuals seek indemnification of potential liabilities that may devolve upon them for acting as trustees of the trust. This indemnification is usually provided out of the property settled in the trust deed. This may be partially addressed if the trustee is a company with limited liability. However, it adds to the transaction costs of pooling funds in a trust structure. Further, unlike public market structures, in private equity type structures, an agency like a trustee appears to have no particular relevance; instead, it adds one more entity to the overall fund structure, and an additional set of operating protocols.

- Uncertainty in treaty eligibility for trusts

The eligibility of a trust to claim tax treaty benefits in case of overseas investments is a contentious issue and the answer would vary depending upon

the language of the tax treaties that India would have entered into with other countries.

Use of LLP in fund structures in India

The LLP was conceptualised as an entity that ensures the corporatisation of small businessmen, who undertake business in the form of sole proprietorship or partnerships.

LLPs are now gaining wider acceptance as they are a blend of the company and partnership firm. An LLP gives flexibility and tax status as that of a partnership while having the status of a body corporate.

LLPs are similar to the Limited Partnership structure that are prevalent in the USA, Cayman Islands, British Virgin Islands and certain Asian jurisdictions like Singapore and Mauritius. In the Indian context, an LLP has two types of partners, Designated Partner ('DP') and others. A DP is responsible for doing of all acts, matters and things as are required to be done by the LLP in respect of compliance of the provisions of Limited Liability Partnership Act, 2008 (LLP Act, 2008) including filing of any document, return, statement and the reports pursuant to the provisions of the LLP Act, 2008. The DP is also liable to all penalties imposed on the LLP for any contravention of these provisions.

There are certain factors which have contributed to the popularity of LLPs, which are as follows:

- Separate corporate identity

The provisions of the LLP Act, 2008 regulate and govern LLPs in India. The LLP Act, 2008 contains provisions for the formation and regulation of LLPs and matters connected therewith or incidental thereto. LLPs have their own separate legal identity, whereby, the partners' liability is limited to their own contribution, perpetual existence, etc. The LLP can continue its existence irrespective of changes in the partners. It can enter into contracts and hold property in its own name. The LLP can wind up either voluntarily or through the intervention of a Tribunal.

- Limited liability

Limited liability protects the partner's personal assets from the liabilities of the business. LLPs are a separate legal entity as compared to the members. Accordingly, no partner is liable on account of the independent or unauthorised actions of other partners; this shield individual partners from the joint liability created by another partner's wrongful business decisions or misconduct. As the LLP is a separate legal entity, its liability shall be met out of its property; however, the liability of the partners is limited to their agreed contribution in the LLP.

- Tax treatment of LLPs

The LLP is a combination of partnership and corporate. For Indian income-tax purposes, LLP is treated as a partnership firm. Hence, any distribution from an LLP to its partners is not taxed. While LLPs are subject to single level tax, the income is assessed at the LLP level instead of assessing income in the hands of the partners in the LLP.

- Flexibility

The written agreement between the partners determines the operation of the LLP and the distribution of profits. This allows for greater flexibility in the management of the business.

- Restructuring/ liquidation of LLP

No prior approval from the Central Government is necessary for increasing the number of partners in the LLP. Any LLP can close or wind up either voluntarily or through the intervention of a Tribunal.

However, LLPs have certain limitations, as noted below:

- Transfer of ownership

If a partner wants to transfer his ownership rights, he must obtain the consent of all the other partners, which can be cumbersome and time consuming. It is essential to provide flexibility to the partners to exit, which is currently not

available in the LLP structure. Constitution documents must be carefully drafted to provide flexibility to exit without requiring consent.

Further, the amendments to the LLP agreement are required to filed with the Registrar of Companies ('RoC'); wherein the amendment agreement is required to be signed by each partner, which is cumbersome in practice.

- Disclosure requirement

The requirement to file public disclosure is another significant disadvantage. An LLP has to file an Annual Statement of Accounts & Solvency and Annual Return with the RoC each year. It must also file the income-tax return with the income-tax authorities for the LLP. The accounts must declare the income of the members, although they may not wish for it to be made public.

Use of company in fund structures in India

Given the regulatory restrictions and compliances involved in the Fund structure, a corporate structure has been sparingly used in the fund industry and has been adopted only in a handful of instances.

A company has certain advantages, which are as follows:

- Incorporated entity and body corporate

A company is an incorporated entity and is treated as a body corporate. Investors and various stakeholders have higher comfort in dealing with a company, although it is currently not very popular for other reasons.

- Separate legal entity

A company exists as a separate legal entity, which is different from its shareholders and members. Shareholders can enter a contract with the company. The company can sue or be sued in its own name.

- Perpetual succession

The company, being an artificial person established by law, continues to exist regardless of the differences in its membership. In simple words, a company is

an artificial person. Factors such as death, insolvency, retirement or the insanity of one or all of the members do not impact the company's status.

- Limited liability

As the company exists as a separate entity, its members are not liable for the debts of the company. The liability of the members of a company is limited to the amount unpaid, if any, in respect of the shares held by them or to the extent of the guarantee amount.

- Transferability of shares

The shareholders of a public limited company can transfer their shares as per the rules laid down in the articles of association. However, in case of a private limited company, there are certain restrictions on the transfer of shares.

- Common seal and artificial legal person

The company is an artificial entity or a person, and therefore, cannot sign its name by itself. This creates the necessity of a common seal that can be used for representing the decisions made on behalf of the company.

- Entitlement to treaty relief

Companies are incorporated as a separate legal entity and are usually entitled to access benefits under the DTAA, unlike trusts or LLPs.

However, the following factors impede the ability to use company as a Fund structure:

- Compliance formalities

Compliance formalities for a company is cumbersome as compared to a trust or an LLP. All companies are required to hold board meetings, general meetings, get the accounts audited, maintain statutory register and file annual return with the RoC each year. In addition to the corporate compliance formalities, a company is also required to maintain compliance with tax and labour laws, which are applicable irrespective of the type of business entity. The compliances consume considerable time and effort .

- Lack of confidentiality

As mentioned earlier, the confidentiality of information with regard to a Fund's activities and its investor base is of paramount importance in a Fund structure. However, in case of a company, the registers and records must be maintained and made available for public inspection at the registered office.

- Tax on distribution

Unlike the LLP structure, the dividends distributed by the Indian company are taxable in the hands of the shareholders. The dividends are distribution of profits earned by the Company, on which the Company would be liable to pay taxes, thereby leading to double taxation, i.e. once in the hands of the Company on the profits earned and secondly in the hands of the shareholders on the distribution received from such Company.

- Flexibility to distribute profits and buy-back of shares/ reduction of share capital

In contrast to the LLP and trust structure, the Companies Act, 2013 does impose certain restrictions on (i) the amount which can be distributed by the Indian Company to their shareholders; (ii) the amount which can be utilised for buy back of its own shares/ reduction of share capital.

8. Need for Variable Capital Company

As mentioned earlier, the IFSCA's objective is to create a globally competitive ecosystem for the sale, distribution and trading of financial products and financial services. Asset management is a key business activity in this eco-system. A regulatory regime that allows more, rather than less, options for setting up funds, is therefore imperative. The global asset management industry is well developed, and countries compete amongst themselves to increase their global market share.

A review of the current Indian fund structures and limitations outlined in Chapter 7 of the report, shows that while India offers multiple structures such as trusts, companies and LLPs for setting up Funds, each of these structures suffer from certain limitations. To address these limitations, some jurisdictions have set up a legal regime for a fourth type of legal entity for the Fund industry, which combines the advantages across these three structures. It combines the advantages of limited liability of a company with the flexibility available in a trust structure of exit and entry without alteration to the capital structure. These entities are called Variable Capital Companies in Singapore, Open-ended Investment Companies in the UK and Open-ended Fund Company in Hong Kong.

The introduction of a law governing VCCs in Singapore is a recent noteworthy success story. Singapore enacted the Variable Capital Companies Act in 2018. Shortly after its enactment, about 100 VCCs have registered with the Accounting and Corporate Regulatory Authority in Singapore. Other popular fund management jurisdictions also offer flexible structures. The Société d'investissement à Capital Variable ('SICAV') in Luxembourg, the Irish Collective Asset-management Vehicle ('ICAV') in Ireland and the Investment Company of Variable Capital ('ICVC') in the UK are other examples. Mauritius has also made an announcement for introduction of VCC as a part of recommendations for a ten-year blueprint in its budget last year.

Introducing the VCC structure in IFSC in India

Taking into account the availability of different legal structures for fund-pooling in India, the developments in global financial centres referred to above and considering the views and counterviews of subject matter experts invited by the Committee, the Committee is of the view that a VCC structure should be enabled for the fund management business in IFSCs in India.

While designing it, focus should be on the desirable features as discussed in Chapter 6 above. It should be simple, it should enable effective segregation and ring-fencing of different pools of assets, offer different classes of fund interests, be able to be set up and wound up quickly, with limited compliance formalities, it should offer flexibility in distribution to shareholders (investors), provide for confidentiality of information and keep the overall costs low.

In the ensuing Chapters of the report, the Committee has provided recommendations on the broad framework for the implementation of the VCC structure in the IFSC including the incorporation of VCC/sub-fund, capital funding, corporate governance, etc. These recommendations are provided considering the current tax and regulatory framework applicable to various entities set up in the IFSC in India.

The Committee believes that the introduction of the VCC regime would be a step in the right direction to develop the IFSC in India as a preferred global hub for international financial services, bring back offshore financial services business and enhance the competitiveness of Indian IFSCs in the global financial market.

9. New law v. amendment to current law

The Committee deliberated on whether a new law for VCCs should be enacted, covering all the aspects relating to incorporation, operations and its winding-up or whether the provisions of the existing Companies Act, 2013, should be extended to VCCs and its sub-funds, with suitable amendments, wherever required.

The Companies Act, 2013, has been in operation for over seven years and is working smoothly. The MCA had released a notification in January 2017 providing relaxations to private and public companies incorporated in IFSC. The Companies Act, 2013, together with its 1956 avatar, has a rich legacy of jurisprudence, which will be lost in case of a new law.

However, the Committee was equally conscious that the Companies Act, 2013, consists of more than 450 sections, several Schedules and Rules. Amending the existing Companies Act to extend it to VCCs and its sub-funds will be a mammoth exercise. All the sections and rules of the Companies Act, 2013 will have to be examined and its impact on the VCC and its sub-funds will have to be analysed. It is very likely that several provisions of the Companies Act, 2013 may not be applicable to VCCs. These provisions will have to be identified and relevant exemptions will have to be provided to the VCCs. Even if the MCA issues a separate notification for VCCs set-up in IFSC, the exemption notification and provisions of the Companies Act, 2013 will have to be read together to understand the provisions applicable to VCCs.

This will go against the fundamental principle of keeping the law simple and the ease of doing business in the IFSC. Non-residents looking to set-up a presence in the IFSC with no prior exposure to India will find this extremely complicated. The VCC law will be very confusing and cumbersome. When a provision of the Companies Act, 2013 is amended, MCA will have to issue separate notifications or make a clear distinction on the applicability of the amendment to VCCs in IFSCs.

Companies will also have to track all amendments and understand the impact of each such amendment on their operations.

As mentioned above, Singapore had enacted the Variable Capital Companies Act, 2018 for governing VCCs incorporated in Singapore. Similarly, the UK has enacted the Open-Ended Investment Companies Regulations 2001 governing open-ended investment companies under the provisions of the Financial Services and Markets Act, 2000. Similarly, Ireland enacted the Irish Collective Asset-management Vehicle Act 2015 governing ICAVs.

In India too, corporate forms have generally been codified in separate laws, such as the LLP Act, 2008. Similarly, co-operative societies with limited liability are governed by the Societies Registration Act, 1860 and trusts are governed by the Indian Trusts Act, 1882.

With respect to common provisions between the law governing VCCs and the Companies Act, 2013 (such as qualification and disqualification of directors, notice for minutes and other compliance related provisions), the Committee deliberated on whether these provisions should be reproduced in the law governing VCCs or should only provide a cross referencing.

Section 67 of the LLP Act, 2008, empowers the Central Government to apply by notification any of the provisions of the Companies Act, 2013 to LLPs also with such exceptions, modifications and adaptations as may be specified in the notification. A similar section can be incorporated in the law governing VCCs.

Section 31 of the IFSCA Act, also empowers the Central Government to modify the provisions of the other enactments in relation to IFSCs. While that option could be explored for introducing the VCC law, the Committee was of the view that there could be some legal challenges in doing so. Section 31 of the IFSCA Act may allow modification of an existing Act but introducing altogether new law for governing the VCCs may be outside its purview.

Therefore, the Committee unanimously preferred a separate Act to be introduced (hereafter, the “Variable Capital Companies Act or VCC Act”), with all the substantive provisions governing the VCC structure.

10. Proposed Variable Capital Company in the IFSC

10.1 Incorporation of VCC and sub-fund

The Variable Capital Company ('VCC') should be an incorporated body corporate with limited liability on the part of its shareholders/ members. The VCC should have:

- a separate legal entity from its shareholders;
- capacity to enter into contracts and hold property;
- perpetual succession; and
- the ability to sue and be sued in its own name.

Much like a company, the internal governance and affairs of a VCC will be regulated by the VCC Act and its constitution documents, namely, certificate of incorporation, its memorandum of association and articles of association. The IFSCA may prescribe additional requirements/ standards for the prudential regulation and governance of a VCC.

Unlike a company, the securities issued by a VCC represent the interest and rights of a shareholder in respect of a sub-fund. Where a sub-fund has more than a certain number of investors, the IFSCA may require the relevant class of shares to be listed and freely tradeable. A VCC may have some sub-funds whose shares are akin to public securities, and other sub-funds whose securities are subject to transfer restrictions akin to a private company. To allow maximum flexibility to a VCC to set-up both 'private' and 'public' sub-funds, a VCC must always be incorporated as a public limited company. This will allow the VCC to set up both public and privately traded sub-funds.

Theoretically, the legal structure of a VCC could be used for various kinds of business activities, which require an internal segregation of revenues,

assets and liabilities. However, bearing in mind the mandate of this Committee and international practices, the Committee recommends that VCCs incorporated in the IFSC should be used as a vehicle for investment management and the extent of the VCC Act may be limited to IFSCs. Therefore, it has refrained from making any suggestions to adopt the VCC for the Indian mainland. If the VCC model is found to benefit the investment management business in the IFSC, its applicability may be extended to the whole of India at an appropriate time. The Special Economic Zones Act, 2005 empowers the Central Government to designate multiple SEZs as IFSCs. The VCC structure should be available in all the SEZs designated as IFSCs.

The share capital of the VCC should be variable in nature. In other words, it should cater to the frequent entry and exit of shareholders without the need for any significant regulatory filings and approval.

The VCC can be set up as a standalone investment fund or structured as an umbrella fund with underlying sub-funds, holding segregated portfolios. The VCC must issue a separate class or classes of shares for each sub-fund within the VCC. The sub-fund of a VCC should not be a legal person separate from the VCC; it should derive its character from the VCC. In mutual fund parlance, a sub-fund is akin to a scheme of a mutual fund. The shares of the sub-funds will be held by investors in the sub-fund.

For the purpose of tax laws, the sub-fund should, however, be treated as a separate entity. It will, for instance, have its own PAN. This has been discussed in detail in Chapter 11 of the report. Further, for the purpose of insolvency proceedings, the sub-funds may be treated as a separate entity. For Fund Managers that structure their Funds as umbrella VCCs, they may use common service providers across the umbrella and its sub-funds.

Objectives of the VCC

Essentially, the VCC is a collective investment scheme or pooling vehicle. The participants, who are the shareholders of the VCC, invest money [or any other asset / contribution] with the objective of making a return or profit from the investment. They invest in the capital of the VCC, but do not have control over the day-to-day management of the VCC. The constitution documents of a VCC should include a Memorandum of Association setting out the main objective of the VCC and other objectives ancillary to the main objective, and an Article of Association, setting out the rules for the internal management of the VCC.

A certain threshold for the alteration of these constitution documents should be prescribed in the VCC Act. A more stringent process for the alteration of these constitution documents, as and when required, may be prescribed in the respective documents, subject to the requirement of filing the details of alterations with the registrar.

Incorporation/ registration process of VCC and sub-fund

The Committee deliberated on whether it was desirable to set-up a separate administrative authority for the purpose of incorporation, reporting and monitoring the compliance requirements by the VCC. The Committee is of the view that the RoC under the Companies Act, 2013 has significant experience in regulating companies over several decades. Setting up a separate regulatory body will result in losing access to that experience, which is not desirable. In the absence of a critical mass of VCCs, setting up a separate regulatory body may be sub-optimal. To achieve the best of both worlds, the Committee recommended that the Central Government should be given the power under the VCC Act to create as many registrars as may be required similar to Section 396 of the Companies Act, 2013 to govern VCC (hereafter referred by 'Registrar of VCC'). The MCA may ensure that the registrar so appointed should not be given any other function in respect

of the regulation of companies or LLPs. However, if the need arises, the Registrar of VCCs may also be authorized to also function as the Registrar of IFSC companies. One such Registrar of VCC should have its office in GIFT City, the place where the Head Office of the IFSCA is located. The MCA must make endeavors to depute officers with international experience at this office. This will allow such officers to leverage their experience and expertise and adopt the best practices followed in comparable international financial services centres. The Registrar of VCC will be the nodal authority responsible for the incorporation, reporting and monitoring the compliance requirements applicable to a VCC under the legal framework governing VCCs.

The current practice of the MCA, whereby the services of the Central and State Government are integrated in a common web form (SPICe+), which offers a bouquet of services, such as incorporation, DIN allotment, PAN and TAN, bank account opening, GST number, etc., should be replicated to support the incorporation and registration of VCCs. This may be extended to cover the approval of the Development Commissioner under the Special Economic Zones Act, 2005 to make it truly a ‘one stop shop’.

The incorporation process should be an interactive one and queries, if any should be raised by the Registrar of VCC on the web-form/ email in a time-bound manner. The applications should be allowed to be re-submitted or sent for clarification and the reasons for the same should be communicated to the applicant. Further, the applicant must be given an opportunity to discuss and amend the application before the same is disposed by the Registrar of VCC.

A VCC may set up one or more sub-funds, without the prior approval of the Registrar of VCC. On the creation of new sub-funds under a particular VCC, the IFSCA should suo-moto intimate information about the sub-fund to the Registrar of VCC. The IFSCA and the Registrar of VCC must have an appropriate information sharing mechanism to facilitate this exchange.

Thereupon, the Registrar of VCC should allot a unique identification number to each sub-fund that may be linked to the VCC.

VCC shall commence its business only upon obtaining a certificate of incorporation from the Registrar of VCC.

Registered office of the VCC

The Committee deliberated at length whether VCCs should be permitted to set-up their registered offices outside of an IFSC. The Committee recognised that fund management activity did not *per se* require the physical presence of the Fund Manager within the IFSC itself. However, the following considerations weighed in on the Committee when considering this question:

1. First, the objective of the IFSC was to create and sustain substantive economic activity in the IFSC. This would be necessary to realise a key objective of creating international financial services centres, namely, that of realizing financial services-linked revenue streams in the IFSC.

2. Second, given that VCCs would be engaged in fund management, they would be under the regulatory scrutiny of the IFSCA. For the purpose of investigation and monitoring, the IFSCA would need access to the books and registers of the VCC which are usually maintained at the registered office. Thus, all records/ documents of the VCC shall be maintained and open for inspection of the IFSCA/ members of VCC at the registered office of the VCC.

3. Lastly, for the regulatory purposes, financial service providers in the IFSC under the Foreign Exchange Management Act, 1999, are treated as persons resident outside India.

On this basis, the Committee recommends that VCCs should at all times, have their registered office in the IFSC. Further, IFSCA may prescribe requirements, if any, in relation to physical presence of directors/ employees of the VCC in IFSC.

Appropriate nomenclature for the VCC/ sub-funds

To allow people dealing with VCCs to distinguish them from companies incorporated under the Companies Act, 2013 and LLPs, the Committee recommended that the VCC should have its name registered with the Registrar of VCC with the last words 'Variable Capital Companies (International Financial Services Company) Limited' or 'VCC (IFSC) Ltd'. The process of obtaining the name of a VCC/ sub-funds shall be similar to the one for companies under Companies Act, 2013. The restrictions applicable to use certain undesirable names would be as prescribed by the MCA.

Open-ended and close-ended funds

Generally, investment funds are categorised as open-ended or close-ended depending on whether investors have discretion to invest and exit/ divest their investments.

Open-ended funds are available for both subscriptions and redemptions by the investors at any point in time. However, a close-ended fund has a predetermined number of investors and does not provide the flexibility to allow subscription or redemption during the lifetime of the fund, once the offer period is closed.

The decision to keep a fund open-ended or close-ended is agnostic to the structure of the entity. Therefore, the Committee recommended that the VCC structure should be available for both open-ended and close-ended strategies. Accordingly, a VCC could have a mix of both, open-ended and

close-ended funds. The funds may be allowed to convert from open-ended to close-ended, and vice versa, in accordance with the norms specified by the IFSCA. In case of public sub-funds, conversion of open ended to close ended scheme shall be subject to consent of investors and exit shall be provided to investors who dissent for such conversion.

It is important to note that a VCC is merely a legal structure available for organizing a fund management business. It will assume the character of the AIF or Mutual Fund or REIT or InvIT, depending upon the registration it obtains. While the VCC Act may prescribe the bare minimum corporate governance and compliance conditions, the IFSCA may enhance those conditions if the sub-fund raises public money.

10.2 Segregation of assets and liabilities of sub-funds

Globally, Fund Managers often set up collective investment schemes under umbrella funds, with each Fund containing multiple sub-funds. The sub-funds are a separate share class within the VCC. The assets and liabilities of each sub-fund are maintained separately, as if they are an independent entity. Each sub-fund may be set up to invest in a different strategy or in a different jurisdiction. These structures are prevalent across various popular fund jurisdictions, such as Luxembourg, Ireland, United Kingdom, Hong Kong, Mauritius and Singapore.

The VCC in the IFSC should also adopt a similar segregated structure. There are several benefits in doing so, the foremost being the ability to keep costs low. The Board of Directors (BoD), regulatory and tax filings, and company secretarial compliances are taken care of at the VCC level, while fund management is undertaken at the sub-fund level. This also ensures accelerated fund set up and registration. The VCC Act may provide a maximum number up to which private & public sub-funds that can be housed in a VCC. Fund Managers can avoid a separate incorporation process for each fund, which can be expensive and time consuming. Segregation is also important from the investors' perspective to ring fence the assets from the losses of the other sub-funds.

In line with the global practice, the governing act for VCC should specifically provide for the segregation of the assets and liabilities of sub-funds. This means that:

- The assets of a sub-fund cannot be used to discharge the liabilities of or claims against the VCC or any other sub-fund of the VCC;
- Any liability incurred on behalf of or attributable to any sub-fund of a VCC must be discharged solely out of the assets of that sub-fund;
- Any income accruing to the sub-fund must be distributed to the investors of that sub-fund or re-invested by that sub-fund, and any loss incurred by a sub-fund must be absorbed by that sub-fund alone; and

- Each sub-fund is bankruptcy remote from the insolvency proceedings initiated in respect of another sub-find.

This would mean that the investors and creditors of a particular sub-fund may claim their returns and fulfil their claims out of the assets of that sub-fund only, and not from the other assets of the VCC (including the assets of any other sub-fund).

A VCC should be permitted to allocate common assets and liabilities not attributable to any sub-fund between the sub-funds in a manner that it considers fair to shareholders. The allocation method based on which various expenses should be allocated, may be prescribed in the constitution document.

As a VCC is the legal entity, it will enter contracts with external parties alone. Further, only a VCC can sue (or be sued by) an investor or a third party and not the sub-funds.

Any charge created on the assets of the VCC shall be registered with the Registrar of VCC. Where the sub-fund acquires any property, which is subject to a charge of any kind, the sub-fund should file a statement of the prescribed particulars with the Registrar of VCC within such time as stipulated.

Cross-cell contagion

The requirement of segregating the assets and liabilities of the sub-funds is key to the functioning of a VCC. To address the key risk of cross-cell contagion, that is, to prevent the assets of one sub-fund from being utilised for/ set-off against the liabilities of another sub-fund, the requirements of asset and liability segregation should override all other requirements applicable to the VCC. The BoD of a VCC should ensure appropriate segregation of assets and liabilities of the sub-funds, and such duty should

be explicitly mentioned in the constitution documents. The BoD must take appropriate care to avoid cross-cell contagion, where the sub-fund invests in a jurisdiction that does not respect cellular type structure.

To discourage co-mingling and prevent cross-cell contagion, appropriate penalty provisions should be introduced under the VCC Act as well.

In case of a VCC raising public funds, investments from one scheme into another scheme should be subject to such conditions as may be stipulated by the IFSCA. In case of private funds, they should be governed by the conditions stipulated in the sub-fund investment document/ agreement with the investors.

Disclosure on dealing with third parties

To ensure that third parties dealing with VCC are aware of the segregated assets and liabilities of sub-funds, a VCC should be required to disclose the name, unique sub-fund identification number and that the sub-funds have segregated assets and liabilities in all documents in which its sub-fund is referred to, prior to entering into agreements on behalf of its sub-fund. All contracts that the VCC enters must contain a provision that restricts any contractual claim to the relevant counterparty to the assets of the sub-fund only. Further, the letterhead of the VCC should contain the phrase ‘An umbrella fund with segregated liability between sub-funds’. The phrase ‘umbrella fund’ would not be relevant in case of a standalone fund.

Further, the Open-ended Investment Company Regulations enacted in the UK also require that certain terms be implied in third-party agreements regarding the consequences of segregated liability. For instance, the clause could read as follows:

'*the party or parties contracting with the umbrella fund shall not seek, by whatever means, to have recourse to any assets of any sub-fund in the discharge of all or part of a liability which was not incurred by that sub-fund*'.

To ensure that the third party is aware about the implications of having segregated liability, the VCC Act should provide to incorporate the above clause in third party agreements. Appropriate penal provisions should be introduced in case the provisions are not complied.

10.3 Equity and Debt Funding

The flexibility to issue and redeem capital as well as easy repatriation of profits to the investors/ shareholders is of paramount importance in a fund structure. To make the VCC a viable fund structure in the IFSC, the Committee believes that maximum flexibility should be provided in terms of issuance, redemption of securities and the repatriation of profits to the shareholders of the VCC, as well as transfer of securities between the shareholders.

Issue of securities

The Companies Act, 2013 allows an Indian company to issue various types of securities, such as equity shares, preference shares, debentures, bonds, etc. Further, such securities may either be convertible or non-convertible, redeemable, with or without voting rights, or partly or fully paid or have any other feature, subject to regulatory restrictions.

The Committee is of the view that, similar to the Companies Act, 2013, a VCC should be allowed to issue all type of instruments as may be permitted by its constitution documents.

Issue of securities by sub-funds

The Committee deliberated on whether the shares should be issued to the shareholders by the VCC or by the sub-funds of the VCC. It was agreed that since sub-funds are not a separate legal person under the VCC Act, it may not be possible for sub-funds to issue shares. Accordingly, the VCC may issue shares to the investors in the sub-funds. Similarly, the VCC may issue debt securities to investors. The debt securities will represent the liability of the relevant underlying sub-funds.

Since the rights of the shareholders of a VCC would be with respect to a particular sub-fund and not the entire VCC, the Committee is of the view that the shares issued by the VCC should represent the rights of the shareholders in respect of a particular sub-fund only. Thus, VCCs should issue shares of different classes, representing an underlying interest in the sub-fund. This is consistent with the practice in other jurisdictions which have similar structures in place for their fund management industry. Similarly, VCCs may issue different classes of debt securities, representing an underlying interest in the relevant sub-fund.

In order to provide flexibility, one sub-fund should be freely permitted to invest in securities of other sub-funds, subject to the restrictions, if any, imposed by the IFSCA in respect of public funds.

Manner of issuance

A sub-fund may be set up as a publicly traded or privately traded sub-fund. The IFSCA may specify the conditions which a publicly traded sub-fund must comply with or the circumstances in which a sub-fund must be necessarily classified as a publicly traded sub-fund (such as a threshold linked to the number of investors, etc.).

In order to facilitate free transfer of securities, all shares/ securities of VCC and their sub-funds should mandatorily be issued in dematerialised form only.

The Companies Act, 2013 provides for penal provisions in case of misstatements and fraudulently inducing investment from the investors/ shareholders. Similar provisions can be introduced for VCCs as well.

Listing of shares/ debentures issued by the sub-funds

VCCs may choose to list shares of any of its public sub-funds on stock exchanges in the IFSC. In case of private sub-funds (whose shares are traded privately), the listing of debt securities issued by such a sub-fund may be allowed.

Transfer of securities and capital re-organisation exercises

The Companies Act, 2013 allows private limited companies to impose restrictions on the transferability of its shares. Further, it imposes restrictions/ prohibitions on the issue, redemption and buy back of securities, as well as for the reduction of the capital of companies. As mentioned above, a VCC may set up sub-funds that are publicly or privately traded. The restrictions on the transferability of the shares of a private sub-fund, will be built into the issuance document of the securities of that sub-fund.

A key intention in fund structures is the ability to allow redemptions (capital reduction), buy-back and exits to investors with ease. In this respect, the framework governing VCCs will differ from that governing a company under the Companies Act, 2013. A VCC should be allowed to freely issue, redeem or buy back the securities issued by it, or undertake capital reduction, without any restriction. In case of private sub-funds, the ability to issue and redeem securities for consideration other than cash may also be provided.

So far as concerns buy-back exercises, in order to protect the interest of the investors, in case of public VCCs, the VCC should make the buyback offer to all the security-holders of the same class and not only to a selected group of shareholders, unless otherwise approved by a prescribed threshold of shareholders of that class.

A VCC should not repurchase or redeem its shares unless they are fully paid up. Shares of a VCC which have been repurchased or redeemed shall be cancelled and the amount of the issued share capital of the VCC should be reduced by the amount of the consideration paid by the VCC for the repurchase or redemption. Such repurchases/ redemptions and consequent reduction of capital shall be reflected in the Annual Report of the VCC.

Rights of shareholders

The Companies Act, 2013 provides various rights to the shareholders with respect to the company, such as the right to participate in profits, attend and vote at general meetings, receive copy of financial statements, inspect statutory register and minutes books, etc.

The rights in respect of each share of any given class would be the right to participate in or receive profits, income or other payments accruing from the sub-fund underlying the share. It will also include right to receive returns arising from the acquisition, holding, management or disposal of the property of that sub fund. It will also further include right to vote at any general meeting of the VCC or at any meeting of shareholders of that class of shares. The basic rights of the shareholders must be recognised in the VCC Act itself. The additional rights may be provided in the constitution documents. In addition, the constitution documents may also provide for conversion of one class of shares into another class of shares.

The rights of the shareholders of a VCC will be restricted to the affairs of the relevant sub-fund. As mentioned above, the VCC should issue shares of different classes, representing the underlying interest in the sub-fund, and the umbrella fund would not have any shares attributable to itself. Accordingly, the investors of the sub-fund should have voting rights only with respect to that sub-fund and not with respect to the entire VCC.

However, in case there are any decisions at the VCC level which could impact all the sub-funds, then the investors of all sub-funds could have voting rights with respect to that decision (such as the appointment or removal of a director, change of registered office, etc.).The circumstances in which the approval of all the investors needs to be sought should be limited only to those matters that could materially affect the interests of all investors. The requirement to obtain a certain minimum threshold of investor approval across all sub-funds should be only in selective cases; the rest should be governed by the constitution documents of the VCC.

The shareholders of a particular sub-fund should not have any interest in the property of the VCC/ other sub-funds of the VCC. This is in line with the separate personality of the VCC from its shareholders.

Valuation of shares

The law in most other jurisdictions with similar Fund structures require the shares of the sub-fund to be valued as per Net Asset Value (NAV) methodology. However, in order to provide greater flexibility, the Committee is of the view that the valuation and redemption of shares of a VCC should be carried out at NAV or as per any other internationally accepted valuation mechanism. The manner of computing the value of shares should be clearly provided in the scheme document. Further, in case the VCC is adopting any methodology other than NAV, the reasons for the same should also be provided in the scheme document.

The valuation of public sub-funds will take place at a frequency to be specified by the IFSCA. For private funds, the valuation frequency shall be prescribed under the relevant scheme documents of the sub-funds.

Payment of dividends

With respect to dividend, the Companies Act, 2013 permits payment of dividend only out of profits of the company, except in certain specified circumstances. A trust or an LLP can, however, distribute its entire capital/ income to the investors.

Investors often demand distributions based on cash flows rather than accounting profits. To make VCC structure at par with the existing Fund structures such as LLPs and trusts, the VCC should be allowed to pay dividends out of its capital as well as profits, subject to positive net worth.

The Companies Act, 2013 also makes various provisions relating to unpaid dividend account and punishment for failure to distribute dividends. Similar provisions could be replicated for public sub-funds of a VCC as well.

10.4 Meetings, Shareholder Register, Accounts and Audit

Meetings

Under the Companies Act, 2013, every company (other than a one-person company) is required to convene an Annual General Meeting (AGM) every year. The law requires that the gap between two AGMs should not be more than 15 months or 6 months from the end of the financial year, whichever is earlier, with an exception in the year of incorporation.

To provide flexibility, it is recommended that VCC and the private sub-funds should not be subjected to a mandatory requirement to hold an AGM. The directors of VCC should have the option to dispense with the requirement to conduct AGM by giving a written notice to their shareholders. The public sub-funds must however, hold AGMs of investors of the relevant sub-fund. Such AGMs could be conducted through video conferencing facility.

The BoD of the Company can call for extraordinary general meeting if circumstances so require. The Companies Act, 2013, also entitles the shareholders to request an extraordinary general meeting (EGM) by giving a special notice. Accordingly, the shareholders of the VCC should be granted a right to call for an EGM by following the prescribed procedures. As the assets and liabilities of the VCC will be segregated at the sub-fund level, there should be flexibility to call for an EGM at each sub-fund level rather than calling for an EGM for the entire VCC. EGMs may also be conducted virtually. The basic principles for conducting the meeting should be laid down in the VCC Act itself. However, the procedure for the conduct of EGMs, including the recording of its minutes, may be left to the respective VCC to be prescribed in their constitutional document.

A company in the IFSC is provided with certain relaxations and exemptions for the preparation of minutes and observing the secretarial standards with respect to general meetings and board meetings, as specified by the

Institute of Company Secretaries of India. Similar relaxations and exemptions should be built in the VCC Act also.

Register of shareholders

The subscribers to the constitution of a VCC are considered to have agreed to become members of the VCC and, on the incorporation of the VCC, their names be entered as members in the register of members. Apart from the subscribers, every other person who agrees to become a member of the VCC and whose name is entered in the register of members is a member of the VCC.

The Committee recognises the need for transparency to prevent the use of VCC for illegal purposes, such as money laundering and terrorism financing, along with the need to maintain investor confidentiality in line with jurisdictions with a sophisticated fund management industry.

To balance these diverse interests, it is recommended that the register of shareholders should be available for inspection only to the shareholders/ members of the concerned sub-fund and not to the general public. The list should ordinarily be maintained at the VCC's registered office unless otherwise agreed by the shareholders in a general meeting. The list of shareholders may be filed with the Registrar of VCC but no disclosure in the financial statements of the VCC should be insisted upon. The Registrar of VCC should not make this information available to the public. However, this register must be disclosed to public authorities upon request for regulatory, supervisory and law enforcement purposes.

Further, the VCC Act may also clearly specify a list of registers and documents, which the shareholders are entitled for inspection and obtaining copies.

Accounting and audit

In line with the principle of segregation of assets and liabilities of each sub-fund, the financial statements of each sub-fund should also be maintained separately. However, the financial statements of all sub-funds may be aggregated (and not consolidated), for filing them with Registrar of VCC or the IFSCA, as may be required.

In case of publicly traded sub-funds, to maintain transparency and allow price discovery of their publicly traded securities, the financial statements of the sub-fund should be made available on the public domain. Such Funds should publish their financial statements on their website, which should be accessible to all. These Funds should mandatorily email the financial statements to the shareholders/ members at their registered email address. At their sole discretion, the Funds may also choose to send physical copies to the shareholder/ members.

However, for privately traded sub-funds, the confidentiality of information is critical. Their financial statements should be made available to the shareholders of the respective sub-funds only. The VCC may be mandated to file the financial statements with the Registrar of VCC/ the IFSCA. However, such information should not be made available to the public on the payment of a fee, as is the current practice for Indian companies and LLP. The Right to Information Act, 2005 provides for certain exemption from disclosure of information, which includes information available to a person in his fiduciary relationship unless the competent authority is satisfied that the larger public interest warrants disclosure of such information. Similar to the above appropriate carve outs may be provided to IFSCA/ Registrar of VCC who would be in possession of the financial statements of privately traded sub-funds.

With regard to accounting standards, differing practices are adopted internationally, with some requiring the use of local financial reporting

standards, while others allowing the use of IFRS or the Generally Accepted Accounting Practice. In line with best global practices, and to provide flexibility, it is recommended that the VCC should be allowed to prepare their financial statements using any financial reporting standard, i.e. US GAAP, or IndAS or IFRS.

The accounting policy followed by sub-funds should clearly be documented in the financial statements.

Audit requirements

Under the Companies Act, 2013, it is mandatory to appoint auditors for a block of five years at a time, and appointment for two such blocks are permitted consecutively for certain companies falling under the criteria for applicability of rotation of auditors. For the IFSC companies, rotation requirements are exempted. It is recommended that a similar exemption be provided for VCCs also. The provisions relating to qualifications and disqualification of auditors, their removal, remuneration, restriction on provision of non- audit services as well disclosures of reasons for resignation of auditors as contained in Companies Act, 2013 should apply to VCCs as well. Similarly, there shall be a provision for reporting of fraud by the auditors, if an auditor in the course of the performance of his duties, has reason to believe that an offence involving fraud is being or has been committed by officers or its employees.

The Companies Act, 2013, has extended exemptions to companies set up in the IFSC from conducting internal audits, subject to the Articles of Association providing so. It is recommended that a similar exemption should be built in the VCC Act. However, an annual external audit of the accounts should be mandatory.

Significant beneficial owners filings

Beneficial ownership interest in a share usually includes the right or entitlement of a person either alone or together with any other person, directly or indirectly, through any contract or arrangement or otherwise and includes:

(i) The exercise or cause to be exercised any or all of the rights attached to such share; or
(ii) the right to receive or participate in any dividend or other distribution in respect of such share.

Indian companies are required file a declaration with the RoC about their significant beneficial owners. A VCC should also be mandated to maintain this information and file with the Registrar of VCC regularly. The Registrar of VCC should however ensure that this information is not made public. The Registrar of VCC / the IFSCA may seek this information in certain circumstances, in which case, the VCC should be mandated to provide the same.

10.5 Corporate governance and management of VCC and sub-fund

To ensure that the IFSC develops as a jurisdiction that investors can trust, the quality of investor protection and overall corporate governance of a VCC, is critical. The framework for corporate governance of a VCC must touch upon the following aspects:

a. ***Disclosures to shareholders, both periodic and event-oriented***: The VCC must prepare its financial statements and annual report in line with the standards of fairness and transparency that are mandated for the financial statements and annual report of companies under the Companies Act, 2013. For publicly traded sub-funds, the IFSCA may mandate additional periodic disclosure of facts that may materially affect the price of the securities.

b. ***Shareholder and board meetings***: The basic principles for conduct of the shareholder and board meetings should be laid down in the VCC Act itself. However, the frequency of annual general meetings of a VCC can be determined by its constitution documents, including the standards for a minimum notice period, the quality of agenda documents, recording of minutes of the meeting, etc. They can be in line with those mandated for shareholders under the Companies Act, 2013.

c. ***Appointment of directors and their remuneration:*** If the VCC raises money from retail shareholders or if it has a sub-fund with publicly traded securities, the IFSCA, as a part of its fund regulations, may require the appointment of at least one independent director.

   Generally speaking, institutional and accredited investors would be the investors who have the prescribed net worth, professional fund management to conduct due diligence for undertaking investments. If the VCC raises funds from institutional and accredited investors only,

the need for the appointment of an independent director should be left to the discretion of the investors. Investors should be free to include it as part of their fund subscription agreement. The independent director should mean a director as defined in Section 149(6) of the Companies Act, 2013.

The appointment, qualification, removal as well as disqualification for the directors should be similar to Chapter XI of the Companies Act, 2013 to the extent applicable. In this regard, specific provisions may be made in the VCC Act.

d. ***Standards for approval and disclosure of interest in connection with, related party transactions***: In order to ensure transparency in dealings of the VCC/ sub-fund, VCC should be required to disclose the transactions with related parties including investment by directors and Fund Managers in the financial statements of the VCC. Disclosures should be as per the relevant accounting standards.

e. Standards for certain critical resolutions, such as the amendment of its constitution documents: The constitution documents of the VCC may be amended as per the process specified in its constitution documents. The rights and obligations of investors, however, may be amended as per the terms of the issuance of the relevant securities. The amendments to the constitution documents may be allowed after securing a special resolution from majority of shareholders of the sub-funds in the VCC.

f. ***Appointment of Company Secretary***: Similar to the Companies Act, 2013, it is recommended that the requirement to appoint a Company Secretary should be mandatory only if the share capital of the VCC exceeds a prescribed threshold. If appointed, the secretary should be resident in India. VCC shall not be obliged to employ a Company

secretary but may secure such services from independent professionals in practice.

Directors and Key Managerial Persons must be fit and proper persons

The Directors and Key Managerial Persons of VCC shall be 'fit and proper persons', i.e. they are persons of integrity, reputation and character, no convictions and restraint orders against them, persons of competence including financial solvency, not declared as wilful defaulters or fugitive economic offenders.

Under the Singapore VCC regime, minimum one director is required for a restricted/ exempt VCC whereas minimum three directors are required in an authorised VCC. In contrast, under OEIC regime, if only one director is appointed, then it would be a body corporate i.e. Authorised Corporate Director. It is recommended that the BoD of the VCC in the IFSC should have a minimum of two directors and at least one of them should be a resident director. The BoD should take the responsibility for the overall conduct of the VCC along with the Fund Manager. The need for the appointment of an independent director should be left to the constitution documents (as described above) and the regulations, if any, made in this regard by the IFSCA for VCCs with publicly traded sub-funds.

The Committee recommends that there is at least one common director between VCC and its Fund Manager to ensure that the management responsibility is undertaken in the best interests of the investors.

Appointment of Fund Manager and custodian of assets

The VCC Act must allow flexibility for each of sub-fund to have a separate Fund Manager, if the responsibility for the conduct of each Fund Manager is undertaken by the VCC (through the directors or its Fund Manager). The Fund Manager must be an IFSCA regulated entity.

Given that the expertise required for fund management differs depending upon the sector(s) and the geography, Fund Managers should be free to delegate fund management to any group company or to an external Fund Manager in any jurisdiction, provided that the Fund Manager undertakes the overall responsibility for their conduct.

A VCC may appoint a custodian in accordance with the requirements, if any laid down by the IFSCA.

10.6 Administration, inspection, inquiry and investigation

Administration of the VCC

The manner of administration of the VCC along with the sub-funds shall be in accordance with Chapter VII – Management and Administration as prescribed under the Companies Act, 2013. However, certain exemptions and modifications applicable to the specified company licensed to operate from the IFSC should be made equally applicable to the VCC set up under the VCC regime. Specific provisions may be made in the VCC Act in this regard.

Relevant authorities for registration / filing

As indicated in Chapter 10.1, the Registrar of VCCs should govern the registration/ incorporation of the VCC. Accordingly, the prescribed filings in respect of intimation of setting up sub-funds, financial information, management related information such as directors, company secretary, etc. should be made to the Registrar of VCCs.

Powers of inspection, investigation and inquiry

The inspection, investigation and inquiry mechanism of the VCC along with the sub-funds should be governed by a separate Chapter in the VCC Act.

Having said the above, it would be important to ensure that the flexibility and ease of conducting investment activities for such VCC should not be hampered by the onerous compliance obligations. Accordingly, the simplified version of the administration, inquiry and investigation should be designed to ensure that the ideal characteristics of VCC structure is not diluted.

10.7 Resolution and liquidation of a VCC and its sub-funds

The VCC may incur two kinds of debt: operational debt, such as rental dues, dues to employees and vendors. VCC may also incur financial debt in form of bank loan or institutional financing to fund its operational activities. A VCC may also issue debt securities to its investors, which represent the interest of the investors/creditors to be repaid from the proceeds of a specific sub-fund. The Committee deliberated whether in addition to contractual remedies, the VCC law should provide for the resolution of the debt incurred by the VCC.

The Committee broke down this question into the following parts: resolution process for operational debt, financial debt availed by the VCC and debt securities issued by the VCC that represent a right to be repaid from the sub-funds.

The Committee noted that while the provisions of the Insolvency and Bankruptcy Code, 2016 ("IBC") could be adequately applied to the resolution of the operational debt and financial debt availed by the VCC, the process provided in the IBC may be sub-optimal in the context of the VCC's debt securities that were to be repaid by the sub-funds. This is because the IBC process affects the corporate body as a whole, and not just the sub-fund that defaults on its creditors. For example, it involves suspension of the board once the National Company Law Tribunal ('NCLT') admits an insolvency resolution petition, the imposition of a moratorium on the recovery of proceeds, the appointment of an resolution professional who manages the affairs of the company during the moratorium period, the constitution of a committee of creditors and eventual liquidation of the company if a resolution plan is not approved by the creditors' committee within a designated timeframe. Applying the IBC to the resolution of debt securities issued by the VCC in respect of a specific sub-fund could therefore lead to an anomalous situation where an underperforming sub-fund could lead to the IBC being triggered in respect of the VCC.

On this basis, the Committee recommended that the IBC should apply to the resolution of a VCC, except in respect of debt securities issued by the VCC which, by their explicit terms, are to be repaid from the proceeds of a sub-fund. Thus, if the VCC commits a default on its operational debt or general financial debt (such as bank loans), the VCC itself or the creditor may initiate proceedings under the IBC in respect of such default. However, where the VCC commits a default in respect of debt securities linked to a sub-fund, the IBC will not apply and the process of resolution should be governed by the scheme document.

A sub-fund may be resolved and liquidated in accordance with the provisions of its scheme document. Where the debt securities of the sub-fund are publicly traded, the IFSCA may prescribe a model procedure, which may be adopted by the sub-funds in their scheme documents with necessary modifications as may be appropriate. This model could also prescribe the rights of the creditors in such situations. In light of recent experience in Indian mutual fund industry, it may be specified that the BoD can take the decision of winding up of the sub-fund only after seeking at least a simple majority consent from the shareholders of the sub-fund.

In Singapore, even though the sub-fund is not a separate legal person, it is required to be wound up as if it were a legal person. The Singapore law also requires the appointment of a liquidator for winding up of a sub-fund. Even under the OEIC regulations, the sub-funds are required to be wound up as if it were an unregistered company under the Insolvency Act and under the OEIC Regulations. However, in order to provide greater flexibility, the Committee is of the view that in the IFSC, the IFSCA may intimate the closure of the sub-fund to the Registrar of VCC under the information sharing mechanism between them, subject to the assets and liabilities of the relevant sub-fund being reduced to Nil.

Voluntary liquidation of the VCC

The Committee noted that the IBC contains provisions that allow a company to be wound up voluntarily. The Companies Act, 2013 also empowers the NCLT to wind up a company on limited grounds, such as, if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality; or where the company's affairs have been conducted in a fraudulent manner.[3]

The Companies Act, 2013 provides for various obligations and requirements for the purpose of winding up a Company. These provisions include the appointment of a liquidator, hosting a meeting of creditors of the Company, publishing in the Official Gazette and placing an advertisement in a newspaper. Such processes are often time-consuming, costly and cumbersome to exit. The process involves multiple touch points with the NCLT and judicial supervision at various stages. The evidence is unclear if the winding up process prescribed under the Companies Act, 2013 brings tangible benefits to the shareholders, creditors or employees of the company which is being wound up. Empirical research on liquidation proceedings in India so far indicates a pro-rescue bias, which often ends up delaying liquidation proceedings.[4] Given that VCCs are likely to be structured as fund vehicles, the processes under the Companies Act, 2013 would be of may be sub-optimal for their winding up.

The IBC governs the voluntary liquidation of body corporates in India, including companies incorporated under the Companies Act, 2013. Chapter V of the IBC deals with voluntary liquidation of corporate persons.

[3] Section 271 of the Companies Act lists out the circumstances in which the NCLT may wind up a company.

[4] Kristin Van Zwieten (2015) Corporate Rescue in India: The Influence of the Courts, Journal of Corporate Law Studies, 15:1, 1-31, DOI: 10.5235/14735970.15.1.1

It allows a company to be voluntarily wound up and dissolved in two ways:

(a) by a special resolution requiring the company to be liquidated voluntarily and appointing an insolvency professional to act as the liquidator; or

(b) an ordinary resolution requiring the company to be liquidated voluntarily as a result of expiry of the period of its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, as the case may be, and appointing an insolvency professional to act as the liquidator:

The voluntary liquidation process under the IBC requires a company to appoint an insolvency professional as a liquidator for administering the liquidation process. The insolvency professional is regulated by the Insolvency and Bankruptcy Board of India (IBBI). The IBC defines the powers of the insolvency professional as a liquidator and the process for collection and verification of claims, in voluntary liquidation. It defines the waterfall for distribution of assets and makes provisions for the avoidance of fraudulent preferences, extortionate credit transactions and undervalued transactions. The voluntary liquidation process under the IBC is relatively simpler to administer and has fewer touch points with the NCLT, saving time and costs. The average time taken for submission of the final report under the voluntary liquidation process is 359 days[5].

Keeping in mind the relative simplicity of the voluntary liquidation process and the business models of fund management activity, the Committee recommends that a VCC may be liquidated in accordance with the provisions governing voluntary liquidation of the IBC. Over and above the requirements specified in Chapter V of the IBC, the insolvency professional must ensure that each sub-fund of the VCC is wound-up before initiating the voluntary liquidation of the VCC.

[5] IBBI Quarterly Newsletter for Jul-Sep 2020
https://www.ibbi.gov.in/uploads/publication/411436dab58c1265aacb015b6b43a215.pdf

The Committee also noted that the IBC has limited applicability to the resolution and liquidation of financial service providers.[6] Since a VCC will necessarily be engaged in the business of fund management, the provisions of the IBC will not be applicable to the resolution and liquidation of VCCs, unless the Central Government notifies a VCC as an entity eligible for resolution and liquidation under the IBC. The Committee, therefore, recommends that the Central Government must, in consultation with the IFSCA, notify a VCC as eligible for resolution and liquidation under the IBC. An appropriate amendment will require to be made to exclude the applicability of the IBC for the resolution of debt securities linked to a sub-fund.

[6] The IBC states that the Central Government may notify any financial service provider or class of financial service providers that may be resolved and liquidated under the IBC. On 15th November, 2019, the Ministry of Corporate Affairs (MCA) has notified the Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules, 2019 (Rules) to provide a generic framework for the insolvency and liquidation proceedings of systemically important Financial Service Providers (FSPs) other than banks. The Rules shall apply to such FSPs or categories of FSPs, as will be notified by the Central Government under section 227 from time to time in consultation with appropriate regulators, for the purpose of their insolvency and liquidation proceedings.

10.8 Merger and acquisition

Globally, the merger of sub-funds is very common, which may be for a variety of reasons. A different Fund Manager may acquire a fund management entity, resulting in similar funds under a Fund Manager. Operating strategies across sub-funds may be similar. Merging sub-funds could result in achieving economies of scale and reduce the compliance burden and compliance cost. There could also be other commercial, regulatory and tax reasons that may prompt sub-fund mergers.

Considering the above scenarios, to provide the required level of flexibility to the VCC and the Fund Managers, the merger/ acquisition of a sub-fund of the VCC with another sub-fund of the same or another VCC should be permitted. The merger/ acquisition of one VCC with another VCC should also be permitted.

Approval and reporting requirements

The Companies Act, 2013 requires companies to obtain the approval of the NCLT prior to a merger/ amalgamation of two companies.

The question of merger or amalgamation, in the case of a VCC, may arise at two levels: at the level of a sub-fund and at the level of a VCC. In the case of a sub-fund, a merger or amalgamation would involve a change to the fundamental attributes of the fund. It would involve a change in the composition of the underlying portfolio and could involve the issuance of new securities to the investors of the sub-funds involved.

Since this affects the substantive rights of the investors, the scheme document must specify the minimum threshold of investors who must approve the merger/ amalgamation, and the manner in which such approval will be sought. Merger/ amalgamation process would be subject to guidelines prescribed by the regulator, i.e. IFSCA In case of publicly traded

sub-funds, the IFSCA may specify a higher threshold and additional requirements (such as a public announcement and a notice period inviting objections) for the approval of the merger/ amalgamation. The IFSCA may additionally specify requirements to report the proposed merger/ amalgamation to the IFSCA and/ or the Registrar of VCC. The same principles will apply to mergers/ amalgamations proposed to be undertaken by a VCC. The Committee is of the view that unlike the Companies Act, 2013, the merger/ amalgamation of two or more sub-funds or VCCs need not be a NCLT-led or NCLT-supervised process. As long as the terms and conditions of the scheme document, the requirements specified by the IFSCA in case of publicly traded sub-fund or VCC, are met, mergers and amalgamations should be voluntary process. Needless to add, if the VCC or any other person violates the terms and conditions of the scheme document or the regulations issued by the IFSCA, the aggrieved investors may seek the redress of the court and any dispute resolution mechanism implemented by the IFSCA.

Shareholders' and creditors' rights

For transparency to investors, the constitution/ scheme document of a VCC/ sub-funds of VCC should clearly set out shareholders' rights in a scheme of merger/ acquisition involving the VCC and its sub-funds. This constitution/ scheme document should be made available to all the shareholders of the VCC/ sub-fund of the VCC.

To ensure proper disclosure, in case a scheme of merger/ amalgamation is proposed, the VCC should provide a scheme document to the shareholders outlining the nature and details of the merger such as the benefits of the merger, the rights and obligations of the shareholders, and the expected timelines. Such disclosure is important to protect the interest of the shareholders and would also be in line with global best practices.

In order to protect the interest of the creditors of the VCC/ sub-fund (e.g. NCD holders), prior approval of such creditors holding specified percentage

of the total debt (in value) as may be prescribed by IFSCA should be required in cases where the merger affects the rights of the creditors.

Off-market transfer of securities

Once the merger/ acquisition of VCC/ sub-funds of VCC is completed, all the assets and liabilities of the merged/ acquired VCC/ sub-fund should be transferred to the remaining VCC/ sub-fund. The Committee is of the view that to provide ease in such transfer, the VCC/ sub-funds should be permitted to undertake the off-market transfer of the securities it holds.

Cross-border mergers

The Committee believes that the cross-border merger of sub-funds of a VCC may also be contemplated, in line with the cross-border mergers permissible under the UCITS regulations.

10.9 Other provisions

The Companies Act, 2013 covers various miscellaneous provisions relating to offences, penalties, compounding of offences, etc. The Companies Act, 2013 covers finer nuances in the provisions relating to the incorporation of companies, issue/ allotment of securities, directors, management and administration, payment of dividend, issuance of prospectus, accounts and statutory auditors, mergers and acquisitions, winding up, etc. as discussed earlier. The Committee believes that these provisions, to the extent they are not inconsistent with any provisions under the VCC Act and are appropriate for a fund structure, may be included in the VCC Act itself. In particular, for example, the restrictions provided under the Companies Act, 2013 with respect to the multi-tier structure and with respect to the subsidiary company holding the shares of its holding company should be captured appropriately in the VCC Act as well.

Further, similar to the Companies Act, 2013, the Central Government should have the power to make rules with respect to the VCC Act. While making the rules, the Central Government may adopt a light touch liberal approach with minimal obligations and restrictions for the VCC.

The Companies Act, 2013 also empowers the Central Government to remove the difficulties arising out of the provisions of the Companies Act, 2013 by way of issuance of an order in the Official Gazette. The Committee believes that the IFSCA should actively engage with the VCCs to understand the difficulties they are facing due to the provisions of the VCC Act and engage with the Central Government to help resolve those difficulties.

There should be a provision similar to section 31 of the IFSCA Act to enable the Central Government to apply, by notification, such provisions of the Companies Act, 2013 to the governance, management and overall affairs

of VCCs with such exceptions, modifications and adaptations, as may be specified in the notification.

10.10 Re-domiciliation

To enable foreign funds to migrate to the IFSC, the Committee deliberated on permitting the re-domiciliation of Indian and foreign funds to the IFSC.

Generally, moving a company from one country to another would require the company to wind up in the home jurisdiction and incorporate afresh in the other jurisdiction. Both these processes can be cumbersome and time consuming.

However, in a typical re-domiciliation (redom), an entity shifts its corporate seat from its country of incorporation to the country of redom. There is no change in the form of the entity. Even the date of incorporation relates back to the original incorporation date. It is merely considered to have changed the place of its incorporation. Redom is different from change in tax residency. In the former instance, the place of incorporation of the company and the place of management of the entity changes, whereas in the latter instance, only the place of management of the entity may change.

Redom does not affect the obligations, liabilities or rights of the offshore fund and retains its corporate history, track record and goodwill. To facilitate the migration of foreign funds/ players to the IFSC, it is recommended that the IFSCA consider granting recognition to offshore corporate funds set up in Financial Action Task Force compliant jurisdictions to operate under the IFSC AIF guidelines with minimum disruptions. This flexibility of migration may also be extended to domestic funds for migration to the IFSC.

On redom, the corporate entity will be required to seek registration as an IFSC VCC along with its sub-fund, if any, under the VCC Act. It is recommended that the registration process of such entities should be similar to any other new VCCs to be set up in the IFSC.

Conceptually, redom should only be permitted for the entity that substantially resembles a VCC. Permitting any other form of entity to redom and morph into a VCC will amount to conversion of that entity into a VCC. Other forms of offshore funds set up as trust, LP, LLP, etc., therefore cannot be re-domiciled as a VCC in the IFSC.

Subject to compliance with local regulations and Foreign Exchange Management Act, 1999, entities set-up in India may also be permitted to redom to IFSC or merge with an entity set-up in IFSC.

The concept of redom is not new and has been successfully implemented in Cyprus, Luxembourg, Mauritius, British Virgin Islands, Ireland, etc., which permit both inbound and outbound redom. It may be noted that Singapore permits only inbound redom while UK OEIC do not permit redom.

In Indian context, section 234 of the Companies Act, 2013, provides for the cross-border merger of Indian and foreign companies. Accordingly, inbound and outbound mergers, amalgamations, or arrangements between Indian and foreign companies are permitted, provided they comply with the Foreign Exchange Management (Cross Border Merger) Regulations, 2018. However, the Companies Act, 2013, does not specifically permit either inbound or outbound redom, as envisaged in this Chapter.

As the concept of redom and cross border merger may need further examination, the Committee recommends that the IFSCA should engage with the Central Government to pave the way forward for its introduction and to prescribe the minimum standards/ requirements for such redom/ cross border merger.

11. Taxation of VCC and sub-funds

Taxation is another important factor while determining an ideal fund structure.

The taxability of the VCC and its sub-funds from India sourced income would be dependent upon the type of registration obtained by the VCC/ sub-funds, i.e. whether as an AIF, Mutual Fund, REITs, InvIT, etc. Accordingly, there should be no requirement to have a separate tax regime for the VCCs and its sub-funds for the income earned from investment in India. In case a new Fund structure is introduced in IFSC, the provisions of the Income-tax Act, 1961 would be required to be amended appropriately.

Tax status of VCC and obtaining PAN

A standalone VCC will normally be regarded as a 'person', and it should be able to obtain a PAN with a 'Company' status.

In case of VCCs with multiple sub-funds, it was deliberated whether the VCC or the sub-funds should be treated as a 'person' for tax purposes. As mentioned in the earlier part of the report, the assets and liabilities of a sub-fund of a VCC are required to be segregated from the other sub-funds. The provision relating to the segregation of assets and liabilities of the sub-funds should be notwithstanding any other provisions of any law governing the VCC. The assets of one sub-fund should not be used to meet the liabilities of the other sub-fund and vice versa.

In case the VCC with multiple sub-funds is regarded as a single person for tax purposes and a single PAN is obtained at the VCC level, the gains/ losses and the taxes paid by the sub-funds would be co-mingled. This would impact the segregation of assets and liabilities amongst the sub-funds. To maintain the sanctity of the segregation and ensure no

comingling/ cross-contamination, it is recommended that each sub-fund be deemed to be a separate 'person' for the purposes of the Income-tax Act, 1961, and be permitted to obtain a separate PAN in its own name and all the provisions of the Income-tax Act, 1961 should be applicable to the sub-funds treating them as a separate person. The PAN as a 'Company' should be allotted to each sub-funds.

Filing tax returns

In Singapore, in case of a VCC with multiple sub-funds, the laws require only one tax return to be filed at the Umbrella Fund level, regardless of the number of sub-funds. The chargeable income of an umbrella VCC is computed as the aggregate of the chargeable income of its sub-funds. In arriving at the chargeable income of each sub-fund, the income tax rules, including the claiming of foreign tax credits, is applied at the sub-fund level. The Committee considered the alternative of filing one tax return for the VCC in India disclosing the income of each sub-fund separately, but the same was not viable as being cumbersome and administratively difficult to implement. Therefore, it is recommended that each sub-fund be required to file a separate tax return in India, disclosing its gains/ losses and taxes.

This model will be in line with the UK ICVC model wherein the sub-funds obtain separate tax registration and file separate tax returns.

It was also deliberated whether a separate PAN at the sub-fund level will increase the compliance burden which will reduce the attractiveness of the VCC. The members of the Committee appreciated that while this may lead to some additional compliances, it was essential to maintain the segregation of assets and liabilities, which was, by far, the most important attraction of the VCC.

In case of a standalone VCC, the VCC should file a tax return.

Availing benefits under the tax treaty

To ensure that the sub-funds are eligible to obtain benefits under the tax treaty on their overseas investments, it is recommended that each sub-fund be regarded as a separate 'taxable unit'. It should be clarified that the sub-funds are 'liable to tax' in India in their own capacity and they are thus entitled to access India tax treaties.

In Singapore, a Tax Residency Certificate (TRC)/ Certificate of Residency (CoR) is issued in the name of the umbrella VCC with the name of the sub-fund included in the CoR. This creates questions with respect to claiming benefits under the tax treaty for investments made by sub-funds.
The Indian tax authorities should issue a TRC at the sub-fund level to make it easy for them to claim the treaty benefits. The applications for TRC should be online and the electronic copy of the TRC should be available on the tax portal for anyone to verify the authenticity of the certificates issued.

A standalone VCC will be a taxable entity and will be 'liable to tax'. A procedure similar to the issue of TRC for a sub-fund should be followed for the standalone VCC also.

Merger and acquisitions of sub-funds of a VCC

For various legal and commercial reasons, the Fund Manager may decide to consolidate two or more VCC/sub-funds. The sub-fund of one VCC may merge with or be acquired by the sub-fund of another VCC.

It is suggested that both mergers and acquisitions of VCC/sub-funds be tax neutral irrespective of whether they are within the same VCC or between two separate VCCs. This would be in line with the global practices in popular fund jurisdictions such as US.

US ‘check the box’ election

The Committee is of the view that VCC and the sub-funds of VCC should have all the requisite features that would make it eligible for the US ‘check the box’ election.

Appendix 1 - Prevalent Fund structures in Global Financial Centres

Appendix 1 -
Prevalent Fund struc

Appendix 2 - Terms of Reference – Expert Committee on VCC

The members of the Committee and its Terms of Reference as extracted from the Office Memorandum dated 22 September, 2020:

Members:

1. Shri K P Krishnan, Chairman (IAS (Retd.))
2. Shri J Ranganayakulu, Member (Former ED (Legal) SEBI)
3. Shri Bobby Parikh, Member (Managing Partner, Bobby Parikh Associates)
4. Shri Ketan Dalal, Member (Founder, Katalyst Advisors LLP)
5. Shri Tushar Sachade, Member (Partner, PwC)
6. Shri Pranay Chaturvedi, Member (Deputy Director, Ministry of Corporate Affairs)
7. Shri Jithesh John, Co-opted Member (Adviser in the Department of Economic Affairs (DEA) Ministry of Finance (MoF))
8. Ms. Bhargavi Zaveri-Shah, Co-opted Member (Senior Researcher, Finance Research Group)
9. Shri Denning K Babu, Member Secretary (DGM, Legal, the IFSCA)

The Terms of Reference of the Committee:

- A comprehensive analysis of fund structures under Indian Trust Act and VCC;
- To examine Singapore VCC structure and suggest appropriate model/ framework that may significantly enhance the competitiveness of the IFSC in India;
- Feasibility of introducing VCC as a separate chapter in Companies Act, 2013 versus need of enacting separate legislation for this purpose;
- To explore alternative structures having characteristics like VCC;
- Any issues which may be considered necessary but not mentioned above.

As per the Office Memorandum dated 22 September 2020, the Committee was required to submit the report within 60 days from the date of its constitution. However, in view of the situation caused by the Covid pandemic, the tenure of the Committee was extended up to 31 May 2021.

End of the Report