Fund Management

In 15 jurisdictions worldwide

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GETTING THE DEAL THROUGH

India

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Fund management

1 How is fund management regulated in your jurisdiction? Which authorities have primary responsibility for regulating funds, fund managers and those marketing funds?

Fund management and marketing in India is regulated by the Indian securities market regulator, the Securities and Exchange Board of India (SEBI) and also, in the case of offshore funds, by the Reserve Bank of India (RBI). The regulations governing the various forms of fund activity primarily include the following.

Onshore funds

- Alternative investment funds (AIFs) – the SEBI (Alternative Investment Funds) Regulations, 2012 (the AIF Regulations).
- Mutual funds – the SEBI (Mutual Fund) Regulations, 1996 (the MF Regulations).
- Collective investment schemes – the SEBI (Collective Investment Schemes) Regulations 1999 (the CIS Regulations).
- Portfolio management – the SEBI (Portfolio Managers) Regulations 1993 (the PMS Regulations).

Offshore funds

- Foreign portfolio investors – the SEBI (Foreign Portfolio Investor) Regulations, 2014 (the FPI Regulations).
- Foreign venture capital investors – the SEBI (Foreign Venture Capital Investor) Regulations, 2000 (the FVCI Regulations).
- Foreign exchange management – the RBI Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000 (TISPRO).

2 Is fund administration regulated in your jurisdiction?

The AIF Regulations and MF Regulations require the funds registered thereunder to submit their books of accounts, which have to be audited annually by a qualified and independent auditor. Additionally, the regulations also require submission of periodic reports (quarterly and otherwise) to SEBI.

Pursuant to the FPI Regulations, SEBI has the power to appoint an auditor to look into the books and records of the foreign portfolio investor.

3 What is the authorisation or licensing process for funds? What are the key requirements that apply to managers and operators of investment funds in your jurisdiction?

The AIF Regulations, MF Regulations, FPI Regulations and FVCI Regulations require funds to register and set out the respective registration processes. The key requirements that apply to managers and operators include a minimum professional experience of five years in portfolio or investment management, meeting the 'fit and proper person' criteria, capital adequacy requirements and infrastructure requirements.

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4 What is the territorial scope of fund regulation? Can an overseas manager perform management activities or provide services to clients in your jurisdiction without authorisation?

There are different regulatory regimes for the regulation of funds located in India and those based offshore. While the AIF Regulations do not specifically prohibit an overseas manager from performing management activities or providing services to clients in India, such a manager would be required to satisfy the adequacy requirements under the AIF Regulations. These specify that the manager should have necessary infrastructure and manpower to discharge its activities effectively. In case of a foreign manager who is managing a fund in India, SEBI may state that the manager does not have the necessary infrastructure onshore to discharge its activities effectively. The overseas manager may be required under the TISPRO, to set up an office in India for the purpose of carrying out business in India.

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5 Is the acquisition of a controlling or non-controlling stake in a fund manager in your jurisdiction subject to prior authorisation by the regulator?

The AIF Regulations require that if there is a change in control of the manager or sponsor of the AIF or the AIF itself, prior approval of the regulator (ie, SEBI) must be obtained. The incoming manager of an AIF must also satisfy the adequacy requirements set out in the AIF Regulations (see question 27).

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6 Are there any regulatory restrictions on the structuring of the fund manager's compensation and profit-sharing arrangements?

No, there are no regulatory restrictions on the structuring of a fund manager's compensation and profit-sharing arrangement. However, SEBI requires AIFs to disclose the proposed fees to be provided by the AIF to the sponsor or manager to SEBI along with detailed tabular examples of how fee and other charges are calculated, how the distribution waterfall is structured and how certain identified 'key man' events are to be handled.

Fund marketing

7 Does the marketing of investment funds in your jurisdiction require authorisation?

There are no specific authorisation requirements in this regard. However, marketing of a retail fund requires the intermediary to satisfy certain criteria set out in question 14. Additionally, marketing of AIFs has to be on a private placement basis and cannot be marketed to the public.

8 What marketing activities require authorisation?

If a public placement is being considered by an investment fund, then prior authorisation from SEBI may be required.

9 What is the territorial scope of your regulation? May an overseas entity perform fund marketing activities in your jurisdiction without authorisation?

SEBI monitors the sale and placement of Indian securities only. Currently, India does not have any specific regulatory regime governing the sale of offshore funds on an unsolicited basis to Indian investors. Therefore, the sale of shares or units of an offshore fund on an unsolicited basis to a resident of India should not trigger manager-licensing issues or fund-registration issues under the laws of India. It is advisable to engage in reverse solicitation for marketing activities in India.

However, prior approval must be sought from the RBI for offshore funds that are marketed by Indian banks or foreign banks in India to Indian residents either for the purposes of soliciting foreign currency deposits in overseas branches, or for acting as agents of overseas mutual funds or any other foreign financial services company.

10 If a local entity must be involved in the fund marketing process, how is this rule satisfied in practice?

Indian or foreign banks must obtain approval from the RBI before marketing an offshore fund in India. Nevertheless, the marketing entity should always adhere to the rules of private placement as an abundant measure of caution.

Retail funds

11 What are the main legal vehicles used to set up a retail fund? How are they formed?

As per the MF Regulations, only trusts can be used as legal vehicles for setting up a mutual fund. In 1964, the Unit Trust of India (a state body that used to be the sole vehicle for retail investments in Indian capital markets), launched its first open-ended equity scheme, Unit 64. This turned out to be one of the most popular mutual fund schemes in the country. In 1987, the government permitted other public sector banks and insurance companies to promote mutual fund schemes. In 1993, SEBI introduced the MF Regulations, which paved the way for the entry of private sector players in the mutual fund industry.

The entry of private sector mutual funds created competitive efficiencies in the industry and helped investors to choose from schemes with different maturity periods and different risk–return profiles. The mutual fund industry in India is highly regulated by SEBI through the MF Regulations.

In addition to domestic investors, the following are permitted to invest in mutual fund schemes under the MF Regulations:

- FPIs subject to their applicable investment limits;
- non-resident Indians; and

• long-term investors such as sovereign wealth funds, multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks registered with SEBI.

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12 What are the key laws and other sets of rules that govern retail funds?

SEBI regulates mutual funds operating in India through the MF Regulations and related rules and circulars issuedby it (in particular, the Master Circular on Mutual Funds). The latest Master Circular on Mutual Funds was issued on 1 October 2014.

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13 Must retail funds be authorised or licensed to be established or marketed in your jurisdiction?

Mutual funds operating in India must be registered with SEBI.

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14 Who can market retail funds? To whom can they be marketed?

Mutual funds or mutual fund units may not be marketed or sold by an intermediary unless they have:

• passed the certification examination conducted by the Association of Mutual Funds of India (AMFI);

• obtained a certification from the National Institute of Securities Markets; and

• obtained a employee unique identification number (EUIN) from the AMFI and an AMFI registration number.

Intermediaries can include distributors, agents, brokers, and sub-brokers. An intermediary can be an individual or a business entity.

If an intermediary is also a broker or sub-broker, registration must be obtained under the SEBI (Stock Broker and Sub-Broker) Regulations 1992. An intermediary that is not a broker or sub-broker and has obtained an AMFI certificate does not require any additional registration with SEBI to sell or market mutual fund units.

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15 Are there any special requirements that apply to managers or operators of retail funds?

The MF Regulations prescribe certain criteria for the appointment of an asset management company (AMC) to manage mutual funds registered thereunder. The MF Regulations require that the AMC be registered with SEBI under the MF Regulations. Additionally, the Regulations impose adequacy requirements regarding, among others, professional experience and net worth for applicants to obtain registration as AMCs before AMCs are eligible to manage mutual funds.

Separately, the TISPRO sets out capitalisation requirements if the AMC has foreign investment. The capitalisation requirements differ, depending upon the percentage of foreign investment in the AMC:

• up to 51 per cent foreign investment: US$500,000, to be brought up front;

• between 51 and 75 per cent foreign investment: US$5 million, to be brought up front; and

• above 75 per cent foreign investment: US$50 million, of which US$7.5 million must be brought up front and the balance brought within 24 months.

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16 What are the investment and borrowing restrictions on retail funds?

Mutual funds can invest in securities, money market instruments, private placed debentures, securitised debt instruments (either asset-backed or mortgage-backed securities), gold or gold-related instruments, real estate assets, infrastructure debt instrument and assets as set out in the MF Regulations.

Mutual funds cannot borrow, except to meet temporary liquidity demands for the purpose of repurchase or redemption of units, or payment of interest or dividends to unit-holders. The amount of any such borrowing shall not exceed 20 per cent of the net assets of the scheme and the duration of the borrowing shall not exceed six months. However, under an exception to the general borrowing restrictions, a mutual fund can lend and borrow securities under the specific framework prescribed by SEBI.

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17 What is the tax treatment of retail funds? Are exemptions available?

A mutual fund is exempt from income tax at the fund level on income and gains arising to the fund from its investments. Dividends distributed by a mutual fund (other than an equity-oriented fund) to its unitholders are taxed depending on the type of mutual fund.

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18 Must the portfolio of assets of a retail fund be held by a separate local custodian? What regulations are in place to protect the fund's assets?

A mutual fund must place and maintain its assets with a custodian registered with SEBI. The custodians are governed by the SEBI (Custodian of Securities) Regulations 1996.

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19 What are the main governance requirements for a retail fund formed in your jurisdiction?

Mutual funds must provide investors with the following documents:

• the offering document;

• a statement of accounts, to be delivered within 30 days from the closure of a new fund offering; and

• annual and semi-annual reports.

In addition to the above, mutual funds are also subject to other ongoing disclosure requirements, which must be made via their websites, including disclosure of:

• the portfolio (along with its international securities identification number) as at the last day of the month for all their schemes. This must be displayed on a fund's website on or before the 10th day of the succeeding month;

• any large holdings, which should be disclosed in the half-yearly and annual results;

• the total commission and expenses paid to distributors satisfying certain conditions;

• an annual report containing accounts of the asset manager to the retail fund;

• the curricula vitae of key personnel; and

• details of investor complaints received by the fund from all sources and vetted by trustees of the fund.

20 What are the periodic reporting requirements for retail funds?

Mutual funds must file the following reports with SEBI:

• audited annual financial statements, including the balance sheet and profit-and-loss account;

• unaudited accounts, on a six-monthly basis;

• quarterly statements of movements in the net assets of the scheme; and

• quarterly portfolio statements, including changes from the previous period, for each scheme.

21 Can the manager or operator place any restrictions on the issue, transfer and redemption of interests in retail funds?

Transfer of investments from one scheme to another scheme in the same mutual fund shall be allowed only if:

• such transfers are done at the prevailing market price for quoted instruments on spot basis. 'Spot basis' shall have the same meaning as specified by the stock exchange for spot transactions; and

• the securities so transferred shall be in conformity with the investment objective of the scheme to which such transfer has been made.

Non-retail pooled funds

22 What are the main legal vehicles used to set up a non-retail fund? How are they formed?

An AIF in India can be set-up in the form of a trust, a company or a limited liability partnership (LLP). Almost all AIFs in India are formed as trusts because the regulatory framework governing trust structures in India is stable and allows the management to write its own standard of governance.

23 What are the key laws and other sets of rules that govern non-retail funds?

In addition to the AIF Regulations, SEBI has also introduced a real estate investment trusts (REITs) regime as well as an infrastructure investment trust regime (InvITs). The SEBI (REITs) Regulations, 2014 and SEBI (InvITs) Regulations, 2014 were notified on 26 September 2014 and have been in force since October 2014.

24 Must non-retail funds be authorised or licensed to be established or marketed in your jurisdiction?

The pooling of non-retail funds is a regulated activity in India and an AIF must be registered with SEBI under the AIF Regulations before beginning its activities as an AIF.

However, the AIF Regulations prescribe a minimum investment amount of 10 million rupees, for all prospective investors of an AIF other than an 'angel fund' (a 2.5 million rupee minimum is available for the fund's employees, directors or manager). The minimum investment amount for an angel fund is 2.5 million rupees for the first three years and also a minimum sponsor commitment of 50 million rupees or 2.5 per cent of the corpus of the AIF, whichever is lower.

25 Who can market non-retail funds? To whom can they be marketed?

AIFs can only be marketed by private placement, however, there is no specific restriction on the class of investor to whom AIFs can be marketed under Indian securities laws. Nevertheless, if a person triggers the 'investment adviser' provisions in the SEBI (Investment Advisers) Regulations 2013 (IA Regulations), they must register with SEBI in accordance with the relevant provisions. The managers of an AIF are exempt from registration requirements under the IA Regulations.

26 Do investor-protection rules restrict ownership in non-retail funds to certain classes of investor?

There are no specific restrictions. However, the minimum investment requirement in a hedge fund is 10 million rupees (a 2.5 million rupee minimum is provided to employees or directors of the fund).

27 Are there any special requirements that apply to managers or operators of non-retail funds?

Through the AIF Regulations, SEBI imposes adequacy requirements for the continuing involvement of the sponsor or manager in the AIF through requirements covering sponsor commitment, infrastructure, manpower and experience of AIF managers.

28 What is the tax treatment of non-retail funds? Are any exemptions available?

The Indian Finance Minister, Arun Jaitley announced the 2015 Union Budget Bill on 28 February 2015. In response to a long-standing demand of the investment funds industry in India, the Finance Minister has sought to extend pass-through status to AIFs that are registered as Category I AIFs or Category II AIFs (together, 'investment funds'). Before the Finance Minister's announcement, pass-through status was only available to Category I AIFs under the venture capital fund (VCF) sub-category and VCFs that were registered under the erstwhile SEBI (Venture Capital Funds) Regulations, 1996.

The Bill provides that any income accruing or arising to, or received by, a unitholder of an investment fund out of investments made in the investment fund shall be liable for income tax in the same manner as if the investments had been made directly by the unitholder. In other words, the income of a unitholder in an investment fund will take the character of the income that accrues or arises to, or is received by, the investment fund.

The Bill also proposes to exempt the income of an investment fund other than income chargeable under the title 'Profits and gains of business or profession'. The memorandum to the Bill also announced that income received by investment funds would be exempted from the collection of tax at source by portfolio companies.

29 Must the portfolio of assets of a non-retail fund be held by a separate local custodian? What regulations are in place to protect the fund's assets?

The sponsor or manager of an AIF under the AIF Regulations is required to appoint a custodian registered with SEBI for safekeeping of its securities if the AIF is a Category III AIF or if the corpus of the AIF is more than 5 billion rupees.

30 What are the main governance requirements for a non-retail fund formed in your jurisdiction?

To register with SEBI as an AIF, pursuant to the AIF Regulations, a fund must fill in Form-A. Schedule II of the AIF Regulations provides for the amount to be paid as fees for registration as an AIF under the relevant category. The AIF Regulations also provide for submission of periodic reports concerning the activities and returns of the AIF to SEBI and the investors. As specified above, the AIF Regulations provide for minimum experience of key personnel of the manager, require the manager or sponsor to have a continuing interest in the AIF, impose certain restrictions on co-investment by the manager in portfolio companies of the AIF, require the manager or sponsor to act in a fiduciary capacity towards its investors and disclose any conflicts, address all investor complaints, maintain records and ensure transparency.

The manager of an AIF is also required to establish and implement written policies to identify, monitor and appropriately mitigate conflicts of interest.

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31 What are the periodic reporting requirements for non-retail funds?

The periodic reporting requirements for non-retail funds are as follows:

• AIFs are required to provide reports to investors at least on an annual basis, within 180 days from the year end containing financial information of the portfolio companies, material risks and their management etc.

• The management fees or fees for the sponsor and any fees charged to the AIF or any portfolio company by an associate of the manager or sponsor have to be periodically disclosed to the investors.

• Category III AIFs are specifically required to provide quarterly reports to investors within 60 days of end of the quarter containing financial information of the portfolio companies, material risks and their management, among others.

• Any significant change in control of the manager, sponsor or any portfolio company has to be announced to the investors.

• Any breach of a provision of the private placement memorandum or agreement made with any investor or any other fund documents, as and when such breach occurs, must be announced to the investors.

• Any operational, portfolio and transaction information regarding the investments of the AIF must be periodically notified to the investors.

• Any material liability, legal proceedings, inquiries and actions by legal or regulatory bodies, as and when they may arise, must be notified to the AIF.

Separately managed accounts

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32 How are separately managed accounts typically structured in your jurisdiction?

The PMS Regulations regulate separately managed accounts in India. Under the PMS Regulations, the

portfolio manager advises, directs or undertakes on behalf of its client the management or administration of a portfolio of securities or the funds of the client pursuant to a contract or arrangement with the client and the underlying assets are held by the clients directly. Portfolio management services under the PMS regulations can be discretionary (where the portfolio manager has the discretion to make investments) and non-discretionary (where the discretion lies with the clients). FPIs registered under the FPI Regulations may also avail themselves of the services of a portfolio manager.

Separately managed accounts can also be an unregulated activity in India if the manager is not undertaking such activities under the PMS Regulations. An alternative is to enter into an investment advisory agreement with the clients to separately manage their accounts. However, this approach may potentially trigger the recently notified SEBI (Investment Advisers) Regulations, 2013 (IA Regulations) wherein an investment adviser is required to register under the IA Regulations for providing investment advisory services to clients.

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33 What are the key legal issues to be determined when structuring a separately managed account?

The key legal issues pertaining to a separately managed account may include the following:

- If the separately managed accounts are not covered under the PMS regulations, then as indicated above, an investment advisory agreement could trigger the IA Regulations.
- While structuring separately managed accounts of foreign investors, it would be important to consider the treaty benefits that can be availed from the double taxation avoidance treaty between India and the jurisdiction where such foreign investors are resident.
- If the clients whose accounts are being managed are foreign investors, and the manager is in India, then there is a tax risk involved concerning permanent establishment. The tax authorities may claim that the presence of the manager in India for foreign investors is a permanent establishment of such investors in India. In this case, the treaty benefits will not be applicable to the foreign investors and their gains from such separately managed accounts may be taxed as business profits arising in India.

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34 Is the management or marketing of separately managed accounts regulated in your jurisdiction?

The management of separately managed accounts is regulated by SEBI through the PMS Regulations. A portfolio manager looking to manage separately managed accounts falling under the PMS Regulations is required to seek registration under the Regulations. This regime is separate from the AIF regime and the MF regime, the management for which is regulated separately.

General

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35 Are there proposals for further regulation of funds, fund managers or marketers of funds in your jurisdiction?

In January 2015, SEBI proposed to remove certain restrictions to allow Indian asset management companies registered under the MF Regulations (AMCs) based in India to be able to manage FPIs

registered as either Category I FPIs or Category II FPIs under the FPI Regulations.

In the 2015 Union Budget, the Finance Minister proposed amendments to encourage fund management activities in India. Under the proposal, an offshore fund having an eligible manager in India should not create a tax presence (business connection) for the fund in India unless certain objective defined parameters have been met.

Under current Indian treaties and domestic law, the presence of a fund manager in India increases the risk of the offshore fund constituting a permanent establishment (PE) or tax presence in India and thereby being subject to tax in India, to the extent attributable to the PE. Today, India-focused offshore funds deal with this risk by engaging managers outside the country, or engaging Indian residents on an advisory basis.

The Finance Minister, in his budget speech, also announced that foreign investment will be allowed in AIFs.

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36 Outline any specific requirements for stock-exchange listing of retail and non-retail funds.

Retail funds

Under the MF regulations, all closed-ended funds (other than an equity-linked savings scheme) must be listed on a recognised stock exchange. Therefore, the secondary market provides an exit route for closed-ended funds. In an open-ended mutual fund, investors can enter and exit the open-ended mutual fund at any point in time, at a price linked to the net asset value of the fund.

Non-retail funds

Closed-ended AIFs can be listed on stock exchanges after final close of the AIF or its scheme with a minimum tradeable amount of 10 million rupees. However, the AIF Regulations prohibit ‘angel funds’ from listing on any recognised stock exchange and no AIF has been listed on a stock exchange so far.

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37 Is it possible to redomicile an overseas vehicle in your jurisdiction?

Current Indian laws do not provide for redomiciling an overseas vehicle in India.

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38 Are there any special rules relating to the ability of foreign investors to invest in funds established or managed in your jurisdiction or domestic investors to invest in funds established or managed abroad?

For foreign investors investing in funds established or managed in India, the exchange control regulations in India currently do not contemplate or provide for investment in funds registered under the new AIF Regulations. In practice, however, we have seen that foreign investors have been permitted to invest in Category I and II AIFs, after obtaining prior regulatory approvals and subject to certain conditions and restrictions. Foreign venture capital funds registered under the FVCI Regulations are permitted to invest into VCFs that were registered with SEBI under the erstwhile SEBI (Venture Capital Funds) Regulations, 1996.

In the 2015 Union Budget, the Finance Minister announced that foreign investment will be allowed in AIFs in the future (see question 35). Although this is a positive development, one has to wait and

see how this measure will be implemented.

For Indian investors investing in foreign funds established or managed abroad, the liberalised remittance scheme (LRS) allows Indian resident individuals to undertake permissible capital and current account transactions. At present, the limit for overseas investments by resident individuals under the LRS is US$125,000 per person but the RBI has announced that the limit is being increased to US$250,000 per person. A circular from the RBI is awaited in this regard.

Companies incorporated in India or bodies created under any act of Parliament or a partnership firm registered under the Indian Partnership Act, 1932 or an LLP incorporated under the Indian Limited Liability Partnership Act, 2008 (body corporate), are allowed to make overseas direct investment under either the automatic route or the approval route by way of contribution to the capital or subscription to the memorandum of a foreign entity. The current overseas direct investment limit for a body corporate under the automatic route is 400 per cent of its net worth as per the body corporate's last audited balance sheet.

Update and trends

If 2014 can be taken as a sign of things to come, India focused-funds are in for an interesting year in 2015. However, from a regulatory viewpoint, the focus on alternative investments has been at its peak. Following the global financial crisis, there has been a growth epidemic in lawmaking focused on the discretionary management industry.

A manager of an AIF must now contend with greater supervision and accountability to both the regulator and the investors. While bespoke terms are designed to maintain investor-friendliness, given the recent observations by regulators in sophisticated jurisdictions, sight must not be lost of the disclosure norms and fiduciary-driven rules that are now statutorily mandated.

Increasing participation by hedge funds in private markets

The year 2014 has shown fund managers being nimble in identifying investment opportunities. High-growth companies are tending to stay private longer. Venture capital and private equity participants are seeing increases of multiples before the companies go for initial public offering (IPO). After such significant increases in firms' valuations, there is typically not much scope for value creation in public markets, which are currently in an overbought phase (though yet to top out).

In other words, there has been a shift in value accretion from the public to the private markets. This has led to several typical public market investors like hedge fund and mutual fund operators shifting from post-IPO to pre-IPO strategies where they reserve a certain allocation of a fund's corpus for private company investments. This requires some structuring not only for entities concerned but also to the fund terms, including understandings on lock-in requirements as there is no immediate liquidity from such unlisted (off the floor of the stock exchange) opportunities.

Operational guidelines for onshore funds

Following closely in the footsteps of the recent observations by the US Securities and Exchange

Commission that there are several disconnects between 'what [general partners] think their [limited partners] know and what LPs actually know', SEBI has issued a circular that consolidates guidelines on disclosures and reporting that AIFs have to comply with.

The circular, inter alia, requires detailed tabular examples of how fee and other charges are calculated and how the distribution waterfall is structured. The circular also provides specifics on how certain identified key-man events are to be handled. This change is critical for fund managers to note. Such disclosure reduces the space for 'views' being taken by a fund manager in a given liquidity event leading to distribution. This also requires that the fund manager engages more closely with the fund counsel to articulate the waterfall in a manner that they can actually implement with a degree of automation. Any deviation from the waterfall as illustrated in the fund documents could potentially be taken up against the fund manager.

Synthetic participation in Indian markets

SEBI issued a circular in November 2014 aligning the conditions for subscription of offshore derivative instruments (ODIs) to those applicable to FPIs under the FPI Regulations.

The investment restriction of keeping aggregate investments in a single portfolio company (a company listed on any recognised stock exchange in India) below 10 per cent of the total issued capital of such portfolio company has also been made applicable to ODI subscribers by the circular. As a consequence of the circular, ODI subscriptions (synthetic contractual arrangements) will be clubbed together with FPI investments for reporting of 'ownership', where at least 50 per cent of the ultimate beneficiaries in the FPI entity and the ODI subscriber are the same.

Indian rupee v US dollar-denominated hurdles

Increasingly, foreign LPs are seeking dollar-denominated hurdles from funds that have a foreign currency-denominated portfolio. This is an emerging trend even in the case of unified structures where the foreign LP participates in a 'feeder' that substantially invests in an India-based 'master' fund (that separately pools Indian LPs). In such situations, where the distribution waterfall is computed at the onshore master level, it is increasingly expected by the offshore LPs that the rupee hurdle match up a dollar-denominated hurdle as well. Care must be taken that there is a passive overlay of the dollar hurdle so as to achieve elimination of the risk of currency exchange volatility and not to add additional return to the portfolio. In case of any shortfalls, the fund would be expected to distribute additional cash flows to all investors (including onshore LPs) before the GP participation in allocations so that both onshore and offshore pools of investors are on the same footing on distributions.

Choice of jurisdiction

After the Organisation for Economic Co-operation and Development issued its report 'Action Plan on Base Erosion and Profit Shifting' in 2013, there is an increased pressure to ensure observance of key tax principles like demonstrating substance, establishing tax-resident status and transfer-pricing principles. With the impending introduction of the General Anti-Avoidance Rule, which allows Indian tax authorities to re-characterise transactions on grounds of lack of commercial substance among

other things, this has prompted a shift while structuring funds toward concentrating several aspects constituting ‘commercial substance’ in the same entity. So, unless specific investors require feeder vehicles for tax or regulatory reasons, an attempt is made to pool LPs in the same vehicle that invests in the foreign portfolio. Mauritius, the Netherlands, Singapore and Luxembourg continue to be popular while structuring Indian funds or funds with an Indian allocation.

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