Variable Capital Companies – the next big boost of capital flows into India

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Introduction of a well-crafted Variable Capital Company structure can help India channelise significant global and domestic capital flows in the alternative investment space.

The Indian Union Budget for 2024-25 announced on July 23 ,2024 made a reference to introduction of Variable Capital Companies in India, which has the potential to provide a significant boost of global and domestic flows in the alternative investment space in India.

Variable Capital Companies (VCCs) represent a progressive structure in the realm of investment funds, providing significant flexibility and efficiency. This structure is designed to enhance the management and operational dynamics of funds, making them more appealing to investors and fund managers alike. Jurisdictions such as Singapore, Mauritius, and the UAE have leveraged the VCC framework to become attractive hubs for capital pooling and investment.

One of the standout features of VCCs is the Umbrella Holding Structure. This structure allows a VCC to consist of multiple sub-funds, each holding assets and liabilities that are legally segregated from the others. This setup offers several advantages:

1. **Clear Regulatory Status**: The Umbrella Holding Structure provides a distinct and transparent regulatory status for each sub-fund. Each sub-fund can have its own investment objectives, policies, and investor base, making regulatory compliance straightforward and specific to each sub-fund's requirements. This separation ensures that the risks and liabilities of one sub-fund do not impact the others, enhancing the overall regulatory clarity.

2. **Matching Risk Profiles**: Investors have diverse risk appetites and investment goals. The Umbrella Holding Structure allows fund managers to create sub-funds with varying risk profiles, investment strategies, and asset classes. This capability enables investors to choose sub-funds that align precisely with their risk tolerance and investment objectives, promoting better investment alignment and satisfaction.

3. **Variable Payouts:** The VCC framework also supports a variable payout structure, making it particularly attractive to sophisticated investors. This flexibility allows fund managers to distribute dividends and capital gains based on the specific performance and yield of each sub-

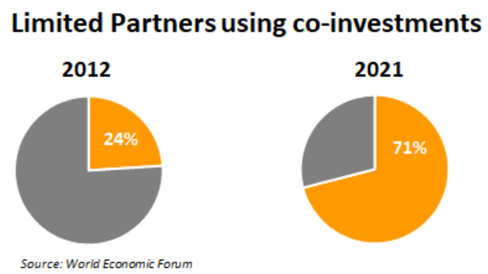
fund. Investors can benefit from tailored payout schedules that align with their financial planning needs and investment strategies. The ability to adjust payouts according to the performance of individual sub-funds enhances the appeal of VCCs, providing sophisticated investors with customized and optimized returns.

The flexibility and efficiency of VCCs have made certain jurisdictions highly attractive for setting up these structures. Singapore has positioned itself as a premier destination for VCCs through robust regulatory frameworks and supportive government policies. The Monetary Authority of Singapore (MAS) has streamlined the process for establishing VCCs, ensuring a conducive environment for fund managers and investors. A clear legal infrastructure, stability in policies and providing a transparent tax pass-through status for regulated fund managers has helped Singapore emerge as an attractive fund management hub. Since the introduction in 2020, Singapore now has around 1,000 VCCs with over 2,000 sub-funds.

The UAE, particularly through financial hubs like the Dubai International Financial Centre (DIFC) and Abu Dhabi Global Market (ADGM), has been focused on progressive regulatory framework, coupled with its zero-tax regime on most forms of investment income, makes it an appealing destination for VCCs. Larger and more sophisticated family offices have leveraged the flexibility that VCC like structures offer to be able to make larger and more distinct decisions on investment opportunities by fund managers in addition to allocations to the standard pooled vehicles.

Mauritius has also focused on offers a favourable tax regime, double taxation avoidance agreements (DTAAs) with numerous countries, and a well-established financial services sector. These factors make it an attractive jurisdiction for VCCs.

A recent survey of global limited partners (i.e. investors in alternative investment funds) by the World Economic Forum noted the use of co-investments by LPs increased from 24% in 2012 to 71% by 2021. Over the same period, the capital flows into the private markets have increased at over20% CAGR to cross US$ 12 trillion. This is illustrative of the impact more flexible regulated structure can have in spurring capital flows.



While global investors have already been leveraging the VCC structures in other jurisdiction for India investments, Indian investors and family offices have been at a disadvantage since they have not been able to use these structures for India investments. Globally participation in alternative investments has been increasing, with allocation to alternative assets increasing by over 5% for institutional investors over the past five years. Indian institutional investors however are yet to make any significant investments in the alternatives space. The unique combination of having one of the largest investment markets and a strong domestic pool of capital can help position India as ne of the largest VCC markets.

A robust regulatory regime which allows for a regulated framework and provides parity to Indian investment houses to match the investments with their own thesis and have greater liquidity alternatives, which a VCC structure can facilitate, has the potential to significantly spur flow of domestic capital pools in the alternative investments space.

Transparency, for investors, regulators and the investees will be a bedrock on which VCCs can truly flourish. Technology frameworks can significantly transform the establishment and management of these structures allowing for wider participation as well as ensuring compliance with the regulatory requirements, while creating greater trust and helping strengthen a virtuous cycle of attracting greater capital to spur innovation.

The views expressed in this document are private opinions of Ausang Shukla, Founder & CEO CapHive Private Limited. CapHive is a provider of next generation technology platforms for private capital markets including platforms for managing the next generation of private market funds, seamlessly managing multi-party transactions and ongoing investor relations management.