

## ERGO

*Analysing developments impacting business*

### SEBI PROPOSES STANDARDISED PRIVATE PLACEMENT MEMORANDUM AND BENCHMARKING FOR AIFS- LEVELLING THE PLAYGROUND?

5 December 2019

With a move that will mark a further evolution of the comparatively young alternative investment fund (AIF) industry, the Securities and Exchange Board of India (SEBI) released "*Consultation Paper on Introduction of Performance Benchmarking and Standardization of Private Placement Memorandum for Alternative Investment Funds*" (Consultation Paper) on 4 December 2019. The primary objective of the Consultation Paper is to bring more uniformity and transparency in the AIF industry. While the Consultation Paper lauds the extraordinary performance of AIFs in the recent past, it also harped upon the need to enhance disclosure standards for AIFs in order to create a conducive investment regime for this asset class.

Accordingly, SEBI has proposed two initiatives to bring about more parity and increased transparency in the AIF industry, i.e. (a) introduction of minimum benchmarks for disclosure of performance history of AIFs; and (b) standardization of private placement memorandum (PPM) for AIFs.

➤ *Minimum benchmarks for disclosure of performance history of AIFs-comparing the likes*

SEBI expressed its concerns over the prevalent practice for AIF managers to only provide standalone performance data for their AIFs to paint a pretty picture for the investors, often cherry-picking the crown jewels of their past performance record. With there being no stringent disclosure norms regarding disclosure of past performance of AIFs or mandatory benchmarking requirement for AIFs, investors are often left without verified sources of information as to the performance of AIFs and have no means to compare performance of such AIFs.

*What will change in relation to benchmarking of AIFs?*

To curb mis-selling of AIFs to investors, SEBI has proposed to introduce a framework to facilitate performance benchmarking of AIFs, including the following measures:

- Reporting of audited performance data by AIFs to benchmarking agencies: AIFs which are registered with SEBI for a minimum of 3 years, will be required to report their audited scheme-wise performance data to SEBI empanelled benchmarking agencies, for benchmarking the individual AIF's performance with comparable industry performance.

- Inclusion of benchmarking report for AIFs in marketing material: Benchmark reports prepared by benchmarking agencies for AIFs must be included in all documents and media coverage dealing with performance of such AIFs.
- Furnishing copy of benchmarking report to investors: A copy of the benchmark report received by the AIF from the benchmarking agencies must be provided to all investors.
- Provision of data on Indian investments by AIF applicants and foreign funds to benchmarking agencies: Investment managers of existing unregistered AIFs, including foreign funds, are required to provide data on their investments in Indian companies, to benchmarking agencies, at the time of seeking registration with SEBI. If existing investment managers furnish any performance data to SEBI, that is based on their previous experience, for application of AIF registration with SEBI, such fund document/marketing material must include the relevant benchmark report.

*What are the steps to be taken for benchmarking of AIFs?*

To effectuate implementation of the above-mentioned measures in relation to benchmarking, the following principal steps are proposed by SEBI:

- Provision of audited data in prescribed format: All AIFs will be required to provide audited data on cash flows and valuation of their scheme-wise investments to the benchmarking agencies in the format prescribed by them.
- Valuation process for AIFs: Periodicity of valuation of investments will be as per the SEBI (AIF) Regulations 2012. Further, AIFs will be required to provide the historical data of valuation of investments to benchmarking agency as a one-time exercise. Valuation of investments will be as per the provisions contained in such regard in the PPM. Any change in the valuation mechanism must be promptly intimated to benchmarking agencies, by the AIF.
- Calculation for the purposes of benchmarking: Assets under Management for the purpose of reporting and benchmarking will be considered the value of total capital draw down for an AIF. Further, performance reporting and benchmarking will be carried out on pre-tax net asset value of the AIF.
- Function of the benchmarking agencies: Benchmarking agencies are required to compile the data received from AIFs and create comparable industry performance benchmarks, separately for each year since 2012. The industry performance benchmark(s) will be accessible to public.
- Parameters for benchmarking to be diverse: In lieu of the diverse investment strategies and avenues for same category AIFs, performance benchmarks may be based on certain other parameters (besides those covered under the Consultation Paper). However, performance benchmarking must be based on objectively verifiable parameters like instrument of investment, tenure/vintage of the fund, focus sectors, etc.
- Benchmarking report: Benchmarking agencies are required to provide a benchmark report to the individual AIFs vis-à-vis the industry benchmark for AIFs. Benchmarking agencies must clearly provide the basis of benchmarking of individual AIFs as well as calculation of industry benchmark in the report.
- Terms of benchmarking: The performance data and benchmarks will be reported in both INR and USD terms, based on the denomination of currency(s) of the capital drawn down. Further, performance benchmarking for AIFs will be on a half yearly basis.

- Eligible benchmarking agencies: Any association of SEBI registered AIFs which in terms of membership in this asset class, represent at least 50% of the registered AIFs, may propose benchmarking agencies.
- Standardization of the PPM: SEBI acts as the cartographer for AIF prospectus map

PPM is the information memorandum for AIFs, that lays down detailed information of an AIF, which includes all material information such as, inter alia, background of investment manager, sponsor, key investment team, targeted investors, fees and expenses, tenure, conditions or limits on redemption, investment strategy, etc. However, the Consultation Paper states that “*disclosing sufficient information does not mean that an abundance of information be presented to the investor in a manner that is complex, convoluted or difficult to comprehend.*” Therefore, while AIF is meant for sophisticated, high ticket investors, not providing such investors with sufficient information debilitates their investment evaluation for AIFs.

Currently, considering that there is no prescribed standardised PPM template for AIFs, SEBI has observed wide-ranging variations in the manner of provision of information in PPMs, be it excessive usage of technical financial jargon that is difficult for investors to understand, or threadbare PPMs with scant information on important sections of the PPM.

In order to introduce minimum standard of information to be made available to investors and to expedite the process of registration for AIFs, SEBI has proposed to introduce a standard template PPM for Category I and Category II AIFs together, and a separate template PPM for Category III AIF (which may be accessed, [here](#)). The template PPMs focus on increasing disclosures and streamline presentation of necessary information in the PPM.

## **Revisions in the auditing compliance requirements for AIFs: increased transparency ensured**

The Consultation Paper also mandates that an audit of compliance of AIFs with the terms of PPM, with special emphasis on impact of side letters on other investors, is required to be carried out by an auditor, on an annual basis. The findings of the audit must be communicated to the trustee, board of the investment manager and SEBI. In case of any adverse findings, the corrective steps taken by the AIF and its constituent are also be submitted.

While presently, such audit may be carried out by an internal or external auditor, SEBI may, going ahead, notify that such AIF suit must be carried out only by an external auditor. Further, summary of audit findings with respect to compliance with terms of PPM shall be shared with all investors.

## **Conclusion**

While the objectives of SEBI as laid down in the Consultation Paper are laudable and with a view to further strengthen the platform from long term growth and sustainability perspective, and to ensure increased transparency, responsible disclosure, and more informed and fortified investors, it would also mean that there is need for a change in the industry practices and mindset for the investment manager community at large. The proposals in the Consultation Paper marks the epoch of maturation of the AIF industry to a more regulated investment regime.

A three-way approach that may be considered by SEBI in this regard, should be to find the perfect balance between (a) not compromising on the flexibility of the AIF regime wherein lies its beauty and success, (b) establish best practices for the industry to build a solid growth platform for this asset class, and (c) not to get too prescriptive and

# ERGO | SEBI PROPOSES STANDARDISED PRIVATE PLACEMENT MEMORANDUM AND BENCHMARKING FOR AIFS- LEVELLING THE PLAYGROUND?

respect the distinction between a product for retail investors vs. more sophisticated investors expected to participate in the alternative asset class.

The Consultation Paper has invited public comments by 25 December 2019. We would encourage the industry to provide constructive feedback to the proposals in the Consultation Paper to ensure that a “win-win” environment can be created amongst all stakeholders, i.e. investment managers, investors and the regulator.

- Siddharth Shah (Partner) and Ishita Khare (Associate)

For any queries please contact: [editors@khaitanco.com](mailto:editors@khaitanco.com)

*We have updated our [Privacy Policy](#), which provides details of how we process your personal data and apply security measures. We will continue to communicate with you based on the information available with us. You may choose to unsubscribe from our communications at any time by clicking [here](#).*

**For private circulation only**

The contents of this email are for informational purposes only and for the reader's personal non-commercial use. The views expressed are not the professional views of Khaitan & Co and do not constitute legal advice. The contents are intended, but not guaranteed, to be correct, complete, or up to date. Khaitan & Co disclaims all liability to any person for any loss or damage caused by errors or omissions, whether arising from negligence, accident or any other cause.

© 2019 Khaitan & Co. All rights reserved.

**Mumbai**

One Indiabulls Centre, 13<sup>th</sup> Floor  
Tower 1 841, Senapati Bapat Marg  
Mumbai 400 013, India

T: +91 22 6636 5000  
E: [mumbai@khaitanco.com](mailto:mumbai@khaitanco.com)

**New Delhi**

Ashoka Estate, 12th Floor  
24 Barakhamba Road  
New Delhi 110 001, India

T: +91 11 4151 5454  
E: [delhi@khaitanco.com](mailto:delhi@khaitanco.com)

**Bengaluru**

Simal, 2nd Floor  
7/1, Ulsoor Road  
Bengaluru 560 042, India

T: +91 80 4339 7000  
E: [bengaluru@khaitanco.com](mailto:bengaluru@khaitanco.com)

**Kolkata**

Emerald House  
1 B Old Post Office Street  
Kolkata 700 001, India

T: +91 33 2248 7000  
E: [kolkata@khaitanco.com](mailto:kolkata@khaitanco.com)