

Regulatory alert: SEBI proposes introducing performance benchmarking and standardisation of private placement memorandum for AIFs

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Summary

Securities and Exchange Board of India (SEBI) has issued a consultation paper inviting comments on the proposal to introduce mandatory performance benchmarking for alternative investment funds (AIFs) and standardisation of private placement memorandum issued by AIFs to investors.

Background

SEBI had issued SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations) on the premise that AIFs would be a high-risk asset class, in which only sophisticated and well-informed investors would participate. It is because of this reason that the AIF Regulations always focused on:

- providing access of all material information to the investors, and
- prior consent from the investor in case of any significant change in the said information.

With an objective to enhance the disclosure standards in the AIF space, SEBI has proposed the following initiatives:

Proposal 1: Introduction of minimum benchmarks for disclosure of performance history of AIFs

Proposal 2: Standardisation of PPM

Proposal 1: Introduction of minimum benchmark for disclosure of performance

In order to minimise potential of miss-selling of AIF products, mandatory performance benchmarking is proposed to be introduced. The performance benchmarking, to be undertaken by certain 'benchmarking' agencies, should facilitate dissemination of necessary information to investors, thereby enabling them to compare individual AIF performance vis-à-vis industry and peer group AIF.

The Consultation Paper provides that any association of AIFs, representing¹ at least 50% of the registered AIFs, may propose one or more benchmarking agencies.

In this regard, SEBI proposes to mandate the following:

¹ In terms of membership

Data to be provided by AIF to Benchmarking

Agencies

- AIFs registered with SEBI for at least 3 years are required to report audited scheme-wise data to benchmarking agencies².
- Audited data on cash flows and valuation of their scheme-wise investments in the format required by the benchmarking agency needs to be provided.
- As a one-time exercise, historical data of valuation of investments is also required to be provided.
- Unregistered fund, including foreign funds, to provide data of their investments in Indian companies to benchmarking agencies as and when they seek AIF registration.

Benchmark report to be provided to investors

- Providing a copy of the benchmark report to all investors.
- Any marketing document disseminating performance of the AIF to be accompanied with the benchmark report.

Aspects to be considered by the benchmarking agency

- Providing a benchmark report to the individual AIFs vis-à-vis the industry benchmark.

- Performance reporting and benchmarking to be carried out on pre-tax net asset value (NAV) of the scheme.
- Performance data and benchmarks shall be reported in both INR and USD terms³
- Assets under management (AUM) for the purpose of reporting and benchmarking would be the value of total capital draw down of the scheme.

Proposal 2: Standardisation of PPM

Currently, AIF Regulations only specify broad areas of disclosures that should form part of the PPM. In the absence of a standard format of PPM, AIFs have been submitting draft PPMs while applying for registration leading to significant variations in the manner in which various clauses, explanations and illustrations are incorporated in the draft PPMs.

Considering the importance of PPM to the investors, to ensure that minimum standard information is available in PPM and to enable time bound processing of AIF applications, Alternative Investment Advisory Committee (AIPAC) on the basis of recommendation received from various stakeholders, has prepared two draft templates of AIFs.

² Each agency to ensure that the benchmarking is based on objectively verifiable parameters like instrument of investment, tenure / vintage of fund, focus sectors, etc.

³ based on the denomination of currency(s) of the capital drawn down.

Separate templates of PPM are provided for Category I/II and Category III AIFs. The draft templates focus on the following aspects:

- a) Riskiness of investments in AIFs
- b) Sequence of presentation of information
- c) List of minimum information to be provided

Further, an annual audit of the terms of PPM with special emphasis on impact of side letters on other investors is also proposed.

The findings of the audit shall be communicated to the trustee, board of the investment manager and SEBI. In case of any adverse findings, corrective steps taken shall also be submitted.

While initially the audit may be carried out by an internal or external auditor, SEBI may notify that the audit shall be carried out only by an external auditor going forward.

Our comments

With the rapid growth of the AIF industry in India, the initiatives of introducing minimum performance benchmark and standardisation of PPM is a welcome move and would create a more conducive environment for AIF as an asset class. The proposed initiatives would help bring the AIF landscape closer to the global standards while simultaneously ensuring that investors make informed decision relating to AIFs. While the said consultation paper issued by SEBI should be acceptable to the fund industry as such, there are a few suggested points which should be considered by SEBI before finalising these norms. Some of these points are as follows:

- Considering investor safety and availability of reliable information, SEBI should mandate approaching benchmarking agencies for AIFs registered for at least one year instead of three years.
- SEBI should ensure that all benchmarking agencies follow a common format for collating information from AIFs.
- While SEBI has briefly provided the factors for determining the performance benchmark, the benchmarking for Category III AIFs should also be based on investible corpus and riskiness of the investment policy.
- A clarification is required as to whether the revised PPM template would apply to AIFs who have already filed their application for registration along with PPMs and also to AIFs who are into fund raising after obtaining SEBI approval.
- As a market practice, many Category III AIFs adopt a carry working mechanism similar to Category I and II AIFs. Accordingly, an option should also be given to Category III AIFs to adopt carry calculation mechanism similar to Category I and II AIFs.

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