

## **Consultation Paper on Introduction of Performance Benchmarking and Standardization of Private Placement Memorandum for Alternative Investment Funds**

### **1. Objective:**

- 1.1. The objective of the consultation paper is to seek comments from the public and industry on the proposals to introduce “Mandatory Performance Benchmarking” and “Standardization of the Private Placement Memorandum (“PPM”) issued to investors by Alternative Investment Funds (“AIFs”) registered under the SEBI (Alternative Investment Fund) Regulations, 2012 (“AIF Regulations”).

### **2. Background:**

- 2.1. AIFs are privately-pooled investment funds which collect funds from investors, whether Indian or foreign, for investing in accordance with a defined investment policy for the benefit of their investors. There are three different categories of AIFs.
- 2.2. Category I AIFs invest in start-up or early stage ventures or social ventures or Small & Medium Enterprises or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable. Category II AIFs include private equity funds and debt funds, while Category III AIFs include hedge funds or funds which trade with a view to make short term returns or such other funds which are open ended.
- 2.3. Total investments made by all categories of AIFs put together has increased from INR 35,099.15 Crore in March 2017 to INR 61,401.57 Crore in March 2018 to INR 109,780.53 Crore in March 2019. The surge in assets may be a function of simplified regulatory framework, options for customization, investment flexibility and robust returns.
- 2.4. AIF Regulations were notified on May 21, 2012 and *inter alia*, provide the framework for registration and governance of AIFs. AIF Regulations are based on the premise that AIFs are a high-risk asset class, in which only sophisticated and well-informed investors participate. AIF Regulations therefore, emphasize on the investors being informed of all material information with regard to the AIFs and whenever any material changes are introduced therein, investor consent is sought prior to executing such changes.
- 2.5. SEBI with an objective to create a conducive environment for a sound Alternative Investment Fund (AIF) asset class in India has been taking several initiatives. One such initiative is to enhance disclosure standards in this space. In this context, the following two initiatives are proposed:
  - a. Introduction of minimum benchmarks for disclosure of performance history of AIFs.
  - b. Standardization of Private Placement Memorandum

### **3. PROPOSAL 1: INTRODUCTION OF MINIMUM BENCHMARKS FOR DISCLOSURE OF PERFORMANCE**

- 3.1. Investments by SEBI registered AIFs have grown at a rate of 75 % year on year growth in the last two years. However, presently there is no disclosure by AIFs indicating returns on their investments and in turn their performance available in public domain.
- 3.2. One important factor on which a prospective investor of AIFs relies while taking investment decision, is the returns on investment generated by the Manager for the Fund(s) managed by him. At present, in the absence of any standards or norms for disclosure of past performance, AIFs disclose their performance to prospective investors on a standalone basis, without reference to an appropriate benchmark. These investors do not have any authenticated source either to verify the performance of such AIFs or to compare with performance of comparable AIFs and AIF industry. Therefore, it is felt that there is a need to provide a framework to benchmarking the performance of AIFs to be available for the investors and to minimize potential of mis-selling.
- 3.3. The performance benchmarking will facilitate dissemination of necessary information on industry performance and the investors (both prospective and current) will be able to compare individual AIF's performance with performance of industry or peer-group AIFs.
- 3.4. In this context, it is proposed to mandate the following:
  - (a) AIFs which are registered with SEBI for at least 3 years, to report their audited scheme-wise performance data to single/multiple Benchmarking Agencies (to be identified later), for benchmarking the individual fund's performance with the comparable industry performance.
  - (b) In all and any documents and media for marketing/promoting the AIF, if any data on the performance of the AIF is mentioned, the Benchmark report of the AIF provided by the Benchmarking Agency to also be provided.
  - (c) A copy of the Benchmark report received by the AIF to be provided to all investors
  - (d) Any investment manager of an existing unregistered Fund, including foreign funds, shall provide the data on their investments in Indian companies, to Benchmarking Agencies, when they seek registration as AIF. If any performance data based on previous experience of the Investment Manager is referred in the fund documents or marketing material furnished to SEBI, the same shall be accompanied by the Benchmark Report received by the Applicant.
- 3.5. If such benchmarking as discussed above, is made mandatory, the major steps in the implementation of benchmarking shall be as follows:

- (a) AIFs to provide audited data on cash flows and valuation of their scheme-wise investments to the Benchmarking Agencies in the format required by the Benchmarking Agency.
- (b) Periodicity of valuation of investments shall be as provided in the AIF Regulations
- (c) AIFs to also provide the historical data of valuation of investments to Benchmarking Agency as a onetime exercise.
- (d) Valuation of investments shall be in the manner provided in the specific Scheme's PPM or fund documents, as the case may be. Any change to valuation approach shall be informed to the Benchmarking Agency in the immediate next data submission.
- (e) Assets under Management (AUM) for the purpose of reporting and benchmarking shall be the value of total capital draw down of the Scheme
- (f) The performance reporting and benchmarking shall be carried out on pre-tax Net Asset Value (NAV) of the Scheme
- (g) Benchmarking Agencies shall compile the data received from AIFs and create comparable industry performance benchmarks for the various categories of AIFs, separately for each year since 2012. The industry performance benchmark(s) will be disseminated in a manner that is accessible to public.
- (h) Considering the diverse investment strategies and investment avenues that can be deployed by an AIF within the same category of AIF, performance benchmarks may be based on certain other parameters (besides those covered under (i) above). Benchmarking Agency shall ensure that such performance benchmarking shall be based on objectively verifiable parameters like instrument of investment, tenure/vintage of the fund, focus sectors, etc.
- (i) Benchmarking Agencies shall provide a Benchmark Report to the individual AIFs vis-à-vis the industry benchmark.
- (j) Each Benchmarking Agency shall clearly provide the basis of benchmarking of individual AIFs as well as calculation of industry Benchmark along with the Benchmark Report.
- (k) The performance data and benchmarks shall be reported in both INR and USD terms, based on the denomination of currency(s) of the capital drawn down.
- (l) Performance Benchmarking shall be on a half yearly basis.

3.6. Any association of SEBI registered AIFs which in terms of membership represent at least 50% of the registered AIFs, may propose one or more Benchmarking Agencies, who shall enter into agreement with AIFs for carrying out benchmarking process. All the AIFs who have been registered for more than 3 years, shall provide the necessary information/data to all the Benchmarking Agencies.

#### **4. PROPOSAL 2: STANDARDIZATION OF PRIVATE PLACEMENT MEMORANDUM**

4.1. Private Placement Memorandum (PPM) provides the necessary information that a prospective investor would need to take an informed decision to invest in a particular AIF.

4.2. As provided in the AIF Regulations,

*“Such information or placement memorandum as specified in sub-regulation (1) shall contain all material information about the Alternative Investment Fund and the Manager, background of key investment team of the Manager, targeted investors, fees and all other expenses proposed to be charged, tenure of the Alternative Investment Fund or scheme, conditions or limits on redemption, investment strategy, risk management tools and parameters employed, key service providers, conflict of interest and procedures to identify and address them, disciplinary history, the terms and conditions on which the Manager offers investment services, its affiliations with other intermediaries, manner of winding up of the Alternative Investment Fund or the scheme and such other information as may be necessary for the investor to take an informed decision on whether to invest in the Alternative Investment Fund. “*

4.3. The AIF Regulations specify only the broad areas of disclosures that should be a part of the PPM. As stated above, the Regulations are based on the premise that AIFs being a high risk asset class, only sophisticated and well informed investors participate in it. However, investors can be well informed only when sufficient information is disclosed by AIFs to them. At the same time, 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.

4.4. While there is no standard format for PPMs presently, AIFs submit draft PPMs to SEBI before launch of their schemes for incorporation of comments received from the Board in the PPM. It is observed that there is significant variation in the manner in which various clauses, explanations and illustrations are incorporated in the PPMs. Therefore, the investors may receive Placement Memorandum which provides information in a manner which is too complex to easily comprehend or with too little information on important aspects of the AIF, for e.g. potential conflict of interests, risk factors specific to AIF or its investment strategy, etc.

4.5. Considering the importance of PPM to investors, to ensure that minimum standard of information be available in PPM and to facilitate the processing of AIF applications in a time bound manner, Alternative Investment Policy Advisory Committee (AIPAC) recommended that the matter be deliberated with the stakeholders.

- 4.6. Based on the inputs received from stakeholders, two draft templates for PPM have been prepared for all Categories of AIF. The draft template for Category I & II AIFs is placed at [Annexure A](#) and draft template for Category III AIFs is placed at [Annexure B](#).
- 4.7. The draft templates for PPM focuses on clarifying the riskiness of investment in AIFs, sequence of presentation of information as well as the list of minimum information to be provided under each heading in the PPM.
- 4.8. On an annual basis, an audit of the compliance of the AIF with the terms of the PPM, with special emphasis on impact of side letters on other investors, shall be carried out by an auditor. The findings of the audit shall be communicated to the Trustee, Board of the Investment Manager and SEBI. In case of any adverse findings, the corrective steps taken shall also be submitted.
- 4.9. Initially, the audit may be carried out by an internal or external auditor. Going ahead, SEBI may notify that the audit shall be carried out only by an external auditor.
- 4.10. Summary of audit findings with respect to compliance with terms of PPM shall be shared with all investors.

## 5. **Public Comments:**

- 5.1. Comments from public are invited on the aforementioned proposal to introduce mandatory Performance Benchmarking and the draft templates of PPMs. The comments should reach SEBI latest by December 25, 2019.

The comments may be sent to [aifreview@sebi.gov.in](mailto:aifreview@sebi.gov.in)

- 5.2. Comments/ suggestions may kindly be provided in the format given below:

Name of the Entity/ Person:			
Sl. No.	Particulars of Issue 1	Suggestions	Rational

Name of the Entity/ Person:			
Sl. No.	Paragraph of the Template for Category I & II	Suggestions	Rational

Name of the Entity/ Person:			
Sl. No.	Paragraph of the Template for Category III	Suggestions	Rational

Name of the Entity/ Person:			
Sl. No.	Other Issues	Suggestions	Rational

[Note: The respondent may specify whether they are market participant (mention type/ category) or public (student, lawyer, investor, academician etc.)]

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