Review of Regulation 17 (a) of SEBI (AIF) Regulations, 2012, with the objective of Ease of Doing Business

1. Objective:

1.1. Category II AIFs are required to invest primarily in unlisted companies. Given the ongoing trend of increase in listed debt and relative shrinkage in the pool of unlisted debt securities, we propose to include AIF Category II investments in listed debt securities rated 'A' or below akin to investments in unlisted securities.

2. Background:

A. Regulatory Provisions in AIF Regulations

2.1. As per the AIF Regulations, Category II funds invest primarily in unlisted securities and 'debt funds' invest primarily in debt securities. It is observed that as on December 31, 2024, there are 196 schemes of Category II AIFs, that have invested more than 50% of their investment portfolio in unlisted debt securities.

2.2. Regulation 17(a) under 'Conditions for Category II Alternative Investment Funds', of the SEBI (Alternative Investment Funds) Regulations, 2012, states as under:

> *"Category II Alternative Investment Funds shall invest in investee companies or in the units of Category I or other Category II Alternative Investment Funds as may be disclosed in the placement memorandum;*
>
> *Explanation. – Category II Alternative Investment Fund shall invest primarily in unlisted companies directly or through investment in units of other Alternative Investment Funds."*

2.3. The term 'primarily' is indicative of where the main thrust of Category II AIFs ought to be. Accordingly, the investment portfolio of a Category II AIF ought to be more in unlisted securities as against the aggregate of other investments.

B. Amendments to SEBI (LODR) Regulations, 2015

2.4. To facilitate transparency in price discovery, due disclosures and to prevent possible mis-selling of such securities. SEBI (LODR) Regulations, 2015 were amended vide notification dated September 20, 2023), introducing Regulation 62A of SEBI (LODR) Regulations, 2015 - Listing of subsequent issuances of non-convertible debt securities by listed entities (hereinafter referred to as "*LODR amendments*"). The relevant text of the LODR Regulations, 2015 is placed at **Annexure A.**

2.5. The impact of the aforesaid LODR amendments is as under:

i. From January 01, 2024 onwards, any listed entity which has outstanding listed debt securities at the time of issuance, will only be able to issue listed debt securities.

ii. Any outstanding unlisted debt security that was issued on or after January 01, 2024, may also require to be listed, if the issuer subsequently lists any of its debt security on stock exchange(s) in future.

C. Representation from stakeholders

2.6. In this context, SEBI has received representations from AIF industry association stating that, adhering to the AIF regulation may become challenging for Category II AIFs, especially for debt funds since, the aforesaid LODR amendments could adversely impact the availability of unlisted debt securities for AIFs in future, thereby, shrinking the investable universe.

2.7. Therefore, with such probable shrinkage, AIFs, particularly debt funds, may find it difficult to meet the requirement that investment portfolio of a Category II AIF ought to be more in unlisted securities as against the aggregate of other investments.

D. Consideration of the Representation

2.8. By virtue of this mandate of primarily investing in unlisted securities, Cat II AIFs, while making investments in unlisted debt securities, assume both liquidity risk and Credit risk. By assuming such risks, AIFs play a crucial role in providing much needed capital to various sectors of economy that may not

otherwise have access to traditional source of funding or companies that are not at a stage of their lifecycle to make a public offering.

2.9. Considering the above, it is deemed appropriate to expand the scope of primary investments of Cat II AIFs to include listed debt securities along with unlisted securities. While doing so, it is also essential that Category II AIFs continue to assume the due credit risk in the ecosystem, akin to their investments in unlisted debt securities.

2.10. In this context, it is viewed that credit rating of a security may be an appropriate parameter to ascertain its credit risk profile. Therefore, it may be appropriate that under listed debt securities, Category II AIFs may be nudged to invest in such listed debt securities that have credit rating 'A' or below, in line with the relatively higher risk appetite of AIFs.

2.11. In view of the above, in order to cater to the aforementioned possible shrinkage in investment opportunities in unlisted debt securities universe, the requirement for Cat II AIFs to invest primarily in designated securities (currently unlisted securities) may also be met by investments in listed debt securities having credit rating 'A' or below.

3. Consultation with stakeholders:

3.1. The proposal was deliberated in the Alternative Investment Policy Advisory Committee ('AIPAC'). AIPAC recommended that along with parameter based on credit rating of securities, SEBI may also consider exploring a parameter based on privately placed listed debt securities, to meet relevant regulatory investment mandate by Category II AIFs. However, it is gathered that since majority of the privately placed debt securities eventually get listed, it may not align with the role envisaged for Category II AIFs, as stated in Para 2.7 above.

3.2. Taking into account the recommendations of AIPAC and internal deliberations, a public consultation paper on the captioned subject matter was issued on February 07, 2025 **(Annexure B)** inviting comments of the stakeholders regarding proposed amendments to Regulation 17 (a) of SEBI AIF Regulations, 2012. The consultation period ended on February 28, 2025.

4. Analysis of public comments:

4.1. 9 responses (summary of analysis of public comments at **Annexure C**) to the consultation paper were received from the public, including from various stakeholders such as IVCA, PEVCCFO Association, AIFs and other market participants**.** Seven of the nine responses either agree or partially agree with the proposal.

4.2. The major comments received in the consultation process and our observations thereon are as under:

Public comment 1 -

4.2.1. There should be no cap on rating of investments, and AIFs shall have the freedom to invest irrespective of rating of listed debt security, as per their own due diligence.

SEBI's response -

4.2.2. AIFs already have the flexibility to invest in listed securities (irrespective of rating criteria) for 50% of their total investable fund.

4.2.3. The instant proposal proposes to expand the universe stipulated under Reg 17(a) of the AIF Regulations. As per the Proposal, listed debt securities have also been proposed to be allowed, subject to meeting certain rating criteria, as a measure of risk, commensurate with higher risk appetite of AIF investors.

Public comment 2 -

4.2.4. Public comments have suggested changes to the overall proposal such as including the spectrum of 'A rating category', allowing securitised debt instruments in addition to listed debt securities, and considering the rating / listing status as on the date of making investments.

SEBI's response -

4.2.5. These suggestions in the public comments merit consideration. The proposal has been revised accordingly.

5. Proposal to amend Regulation 17 (a) of AIF Regulations, 2012

Taking into account SEBI's discussions with AIPAC and the AIF industry, comments received from public and internal deliberations, the 'Explanation' to Regulation 17 (a) of AIF Regulations is proposed to be amended as under –

"Category II Alternative Investment Fund shall invest primarily in unlisted securities and/or listed debt securities (including securitised debt instruments) which are rated 'A' or below by a credit rating agency, directly or through investment in units of other Alternative Investment Funds, in the manner as may be specified by the Board."

6. Proposal to the Board -

6.1. The Board may consider and approve the proposal at para 5 above to suitably amend the AIF Regulations.

6.2. The draft amendment to the AIF Regulations and the draft notification for the proposed amendment are placed at **Annexure D** and **Annexure E** respectively.

6.3. The Board is requested to consider and approve the proposals in the Memorandum. The Board is also requested to kindly authorize the Chairperson to make consequential/incidental changes and take necessary steps to give effect to the decisions of the Board.

Encl:

1. Annexure A (01 pages) - Relevant text of LODR regulations, 2015
2. Annexure B (05 pages) – Consultation Paper on review of Regulation 17 (a) of SEBI (AIF) Regulations, 2012, with the objective of Ease of Doing Business
3. Annexure C (04 pages) - Brief summary of public comments received and SEBI's views on the same.
4. Annexure D (01 pages) – Draft amendment to AIF Regulations
5. Annexure E (04 pages) – Draft notification for the proposed amendment

Annexure A

Relevant text of SEBI (LODR) Regulations, 2015

62A. Listing of subsequent issuances of non-convertible debt securities

1. *A listed entity, whose non-convertible debt securities are listed shall list all non-convertible debt securities, proposed to be issued on or after January 1, 2024, on the stock exchange(s).*
2. *A listed entity, whose subsequent issues of unlisted non-convertible debt securities made on or before December 31, 2023 are outstanding on the said date, may list such securities, on the stock exchange(s).*
3. *A listed entity that proposes to list the non-convertible debt securities on the stock exchange(s) on or after January 1, 2024, shall list all outstanding unlisted non-convertible debt securities previously issued on or after January 1, 2024, on the stock exchange(s) within three months from the date of the listing of the non-convertible debt securities proposed to be listed.*

Annexure B

The consultation paper is available at the following link:

https://www.sebi.gov.in/reports-and-statistics/reports/feb-2025/consultation-paper-on-review-of-regulation-17-a-of-sebi-aif-regulations-2012-with-the-objective-of-ease-of-doing-business_91737.html

Annexure C

This has been excised for reasons of confidentiality.

Annexure D

Amendment to SEBI (Alternative Investment Funds) Regulations, 2012, shall be notified after following the due process.

Annexure E

Amendment to SEBI (Alternative Investment Funds) Regulations, 2012, shall be notified after following the due process.