

**Amendments to SEBI (Portfolio Managers) Regulations, 2020
and SEBI (Alternative Investment Funds) Regulations, 2012**

1. Objective

1.1 This Board Memorandum proposes to amend the SEBI (Portfolio Managers) Regulations, 2020 (“the PMS Regulations”) and the SEBI (Alternative Investment Funds) Regulations, 2012 (“the AIF Regulations”) to facilitate co-investment by investors of Alternative Investment Funds (AIF) through portfolio management route.

2. Background

2.1 The Manager of an AIF (hereinafter referred to as “the Manager”) may offer investment opportunity to the investors, including investors of the AIF, for additional investment in unlisted securities of an investee company, where the AIF is also investing or has already invested. Such investment opportunity offered at the discretion of the Manager considering factors such as the size of investment, strategic value of the investor, etc. is referred to as co-investment in AIF industry. The Manager and the Sponsor of the AIF may also co-invest. In terms of AIF Regulations, co-investment in an investee company by a Manager or Sponsor shall not be on terms more favourable than those offered to the AIF.

2.2 AIF is a pooled investment vehicle, where the investors have rights in each investment of the AIF in the ratio of their contribution in the AIF, i.e. pro rata basis. To maintain the said characteristic of pooled investment vehicle, any co-investment by an investor of the fund, is not carried out within the fund structure. In the current regulatory framework there is no prohibition for the Manager to provide co-investment opportunity to co-investors outside the fund structure. Generally, such co-investment opportunities are offered by the Managers of Category I and II AIFs.

2.3 In this context, SEBI has received representation from the AIF industry, highlighting, inter alia, the following constraints faced by Category I and II AIFs, who invest primarily in unlisted securities, while offering co-investment outside the fund structure—

2.3.1 In the past, one of the routes to carry out such co-investment used to be through SEBI registered Portfolio Managers under the erstwhile SEBI (Portfolio Managers) Regulations, 1993. However, subsequent to the notification of PMS Regulations on January 16, 2020, discretionary Portfolio Managers cannot invest funds of their clients in unlisted securities and the Portfolio Managers offering non-discretionary or advisory services can invest or advise investment in unlisted securities only up to 25% of the assets under management of the clients. As co-investment is generally made in unlisted securities, the portfolio management route earlier followed by Managers has become restrictive for such co-investment.

2.3.2 Further, as per PMS Regulations, the clients have the option for early termination of the portfolio management contract/agreement as well as for the early withdrawal of funds and securities, thereby allowing the investor to exit from an investment before the expiry of the tenure of the contract. The Manager offering co-investment is expected to align the interests of co-investors with those of the AIF so that the interests of investors of the AIF are not adversely affected by the co-investment. If the co-investor makes an early exit/divestment from the investment, such decision may not align the interests of the investors of the AIF with that of the co-investor. This may adversely affect the interests of investors of the AIF.

2.3.3 Apart from the portfolio management route, the Manager can advise co-investment through investment advisory route. However, the same does not enable the Manager to maintain alignment of interests of the investors of the AIF with that of the co-investor, since the co-investor has the discretion to take investment management decisions, including exit from investment and the Manager only provides advice to the co-investor.

2.3.4 In view of the above, AIF industry represented to allow co-investment within the AIF structure by issuing separate class of units to the co-investors.

2.4 Based on the aforesaid representations from AIF industry and internal discussions, the matter was placed before the Alternative Investment Policy Advisory Committee (hereinafter referred to as “AIPAC” or “the Committee”) for deliberation and the Committee viewed the following:

2.4.1 Pooling of funds is an essential characteristic of an AIF which provides the AIF a distinct identity from its investors and hence should not be compromised. Therefore, the proposal to allow co-investment within the AIF structure by issuing separate class of units to the co-investors cannot be acceded to.

2.4.2 In order to facilitate the Managers to manage the co-investment of their investors in unlisted securities outside the AIF framework, amendment to the PMS Regulations to enable co-investment through portfolio management route, merits consideration.

2.5 Accordingly, the following issues are placed before the Board for consideration.

3. Issues for Consideration

3.1 Framework for co-investment

(a) In terms of the PMS Regulations, a portfolio manager is a body corporate, which pursuant to a contract with a client, advises or directs or undertakes on behalf of the client, whether as a discretionary portfolio manager, where the investment decisions are at the discretion of the portfolio manager, or otherwise, the management or administration of a portfolio of securities or goods or funds of the client, as the case may be.

(b) It is envisaged that the co-investment services by the Managers through the portfolio management route shall be limited to providing additional investment in unlisted securities of investee companies of the AIFs managed by it and only to investors of such AIFs as clients provided that such AIFs be sponsored by the same Sponsor(s). Further, while the investors may have the discretion to take investment decisions under co-

investment, the terms of co-investment may not be more favourable than the terms offered to the AIF and the terms of exit from the co-investment including the timing of exit, may be identical to the terms applicable to the exit by AIF. Thus, such co-investment services shall be different from discretionary, non-discretionary portfolio management services or advisory services as presently provided for in the PMS Regulations.

(c) Further, the requirement of minimum investment amounts for services of portfolio manager and investment in an AIF is INR 50 lakhs and INR 1 crore respectively. If seen in a hierarchical manner, investors in an AIF are considered to be relatively more sophisticated and are expected to have better understanding to scrutinize and analyse the credentials of the Manager and its personnel. Therefore, for providing co-investment through portfolio management route, relaxing certain requirements under PMS Regulations for the Manager, merits consideration.

(d) Accordingly, the PMS Regulations may need to be suitably amended, wherever necessary, to facilitate co-investment by investors of AIF, through Portfolio Managers as well as through Managers seeking fresh registration as Portfolio Managers who intend to provide only co-investment services, and the following definitions are proposed to be inserted in the PMS Regulations:

[The definitions shall be provided in the amendment to SEBI (Portfolio Managers) Regulations, 2020, which shall be notified after following the due process.]

(e) The term 'co-investment' has been referred in AIF Regulations only in the context of co-investment by Manager or Sponsor, which are proprietary investments. Thus, the co-investment by Manager or Sponsor may not be under the proposed framework for co-investment through the portfolio management route. However, co-investment by investors of AIF may only be through the portfolio management route. Therefore, it is proposed that AIF Regulations may be suitably amended to provide that co-investment by

investors of AIF shall only be through a Co-investment Portfolio Manager as specified under the PMS Regulations.

- (f) Further, since the term 'co-investment' has not been defined in AIF Regulations, it is proposed that the following definition of co-investment may be inserted in AIF Regulations –

[The definition shall be provided in the amendment to SEBI (Alternative Investment Funds) Regulations, 2012, which shall be notified after following the due process.]

3.2 Investment in unlisted securities

- (a) In terms of Regulation 24(3) of the PMS Regulations, a Portfolio Manager offering discretionary services cannot invest in unlisted securities. Further, in terms of Regulation 24(4) of the PMS Regulations, a Portfolio Manager offering non-discretionary or advisory services may invest or provide advice for investment up to 25% of the assets under management of such clients in unlisted securities. The industry representation sought exemption from the aforesaid provisions for Co-investment through portfolio management route.
- (b) AIPAC deliberated that Category I and II AIFs invest primarily in unlisted securities and the aforesaid provisions of the PMS Regulations appear to be restrictive. Thus, it was recommended that for Co-investment through portfolio management route, Portfolio Managers may be allowed to invest 100% of the assets under management in unlisted securities.
- (c) It is proposed to accept the recommendations of AIPAC and accordingly the PMS Regulations may be suitably amended to allow Co-investment Portfolio Managers to invest 100% of the assets under their management in unlisted securities.

3.3 Minimum investment amount

- (a) Presently in terms of the Regulation 23(2) of the PMS Regulations, the minimum investment amount for a client of Portfolio Manager is INR 50 lakh. The industry representation sought exemption from the aforesaid minimum investment amount requirement. Further in terms of Regulation 24(1)(b) of the PMS Regulations, renewal of portfolio on maturity of the initial period of contract shall be deemed as a fresh placement.
- (b) AIPAC recommended that, since the clients under Co-investment through portfolio management route shall only be co-investors and would have already committed the minimum investment amount of at least INR 1 crore in the AIF, the requirement for minimum investment amount under PMS Regulations may be relaxed for co-investors.
- (c) It is proposed to accept the recommendation of AIPAC and accordingly the PMS Regulations may be suitably amended so that the requirement of minimum investment amount may not be applicable to Co-investment Portfolio Managers. Thus, the provision of renewal of portfolio on maturity being deemed as fresh placement (which is in the context of minimum investment amount) may not be applicable to Co-investment Portfolio Managers and PMS Regulations may be suitably amended in this regards.

3.4 Appointment of Custodian

- (a) In terms of Regulation 26 of the PMS Regulations, Portfolio Managers except for those who provide only advisory services, are required to appoint a custodian in respect of securities managed or administered by it. In terms of AIF Regulations, the Sponsor or Manager of Category I and Category II AIF is required to appoint a custodian if the corpus of the AIF is more than INR 500 crore.
- (b) Based on industry representation and deliberation in AIPAC, the Committee recommended that the requirement of mandatory appointment of custodian may be relaxed for Co-investment through portfolio management route,

since such Co-investment will be an extension of investments of the AIF. However, the Manager of the AIF may be required to appoint a custodian if the combined size of the corpus of the AIF and the value of Co-investment through portfolio management route, exceeds INR 500 crore.

- (c) It is proposed to accept the recommendation of AIPAC and accordingly the PMS Regulations may be suitably amended to specify that the requirement of appointment of custodian may not be applicable to Co-investment Portfolio Managers.

3.5 Contract with clients

- (a) As per the provisions of Regulation 22 of the PMS Regulations, a Portfolio Manager has to enter into an agreement in writing with such client as specified in Schedule IV of PMS Regulations, including the provisions of early termination and terms of early withdrawal of funds by the clients and containing their mutual rights, liabilities and obligations relating to management of portfolio. Further, in terms of Regulation 15(1)(b) of the AIF Regulations, Co-investment in an investee company by a Manager or Sponsor shall not be on terms more favourable than those offered to the AIF.
- (b) Based on the industry representation, AIPAC recommended that Co-investment through portfolio management route may have the same clients as that of the AIF and that the Manager may be required to align the interests of co-investors with that of the investors of the AIF managed by it. AIPAC further recommended to not allow the clients to terminate the agreement and withdraw funds before maturity of the contract.
- (c) Although AIPAC has recommended that Co-investment through portfolio management route may only have the same clients as that of the AIF, however, to provide flexibility to the Manager, the proposed framework for Co-investment may have a client which is an investor of any of the AIFs

managed by the Manager, provided that such AIFs are sponsored by the same Sponsor(s).

- (d) Also, it is envisaged that while the investors may have the discretion to take investment decisions under Co-investment, the terms of Co-investment may not be more favourable than the terms offered to the AIF and the terms of exit from the Co-investment including the timing of exit, may be identical to the terms applicable to the exit by AIF. Accordingly, it is proposed that PMS Regulations may be suitably amended to provide that early withdrawal of funds by the co-investors may be subject to exit by the AIF from respective investment(s). It is further proposed that in case of multiple Co-investments, the funds may be withdrawn by a co-investor with respect to Co-investment(s) in an investee company to the extent that the AIF has also made an exit from respective investment in such investee company.

- (e) Considering that the interests of co-investors in an investee company are required to be aligned with that of the interests of the investors of the AIF, it is proposed that the PMS Regulations may be suitably amended to provide that the terms of Co-investments in an investee company by a co-investor may not be more favourable than the terms of investment of the AIF. The terms of exit including the timing of exit from the Co-investment by a co-investor may be identical to the terms applicable to the exit by AIF. It is further proposed that withdrawal of funds by the co-investor may be allowed for Co-investment(s) in an investee company to the extent that the AIF has also made an exit from respective investment in such investee company.

- (f) In case of co-investment by Manager or Sponsor in an investee company, which are proprietary investments, it is felt that interests of the investors of the AIF are also required to be aligned with that of the interests of Manager or Sponsor. It is therefore proposed that the AIF Regulations may also be suitably amended to provide that the terms of Co-investment in an investee company by the Manager or Sponsor or co-investor may not be more favourable than the terms of investment of the AIF. The terms of exit

including the timing of exit from the Co-investment by the Manager or Sponsor or co-investor may be identical to the terms applicable to the exit by AIF. However Co-investment made by the Manager or Sponsor, prior to the proposed amendments, may continue to be governed by the existing provisions.

3.6 Manager acting as an Investment Adviser

- (a) As per Regulation 4(h) of the SEBI (Investment Advisers) Regulations 2013, the Manager is not required to seek registration as Investment Adviser to act as an investment adviser. As also stated in the industry representation, Manager of an AIF may advise investment opportunities to any investors for investment in securities of investee companies, where AIF is also investing or has invested .
- (b) The investor receiving such investment advice from the Manager may independently decide the terms of exit including the timing of the exit from such investments which may not necessarily be identical to the terms applicable to the exit by the AIF, thus not in interest of the investors of the AIF.
- (c) It is therefore proposed that the AIF Regulations may be suitably amended to provide that the Manager may not advise any investor other than the clients of the Co-investment Portfolio Manager as specified under PMS Regulations, in respect of investment in securities of investee companies where the AIF is also making or has made investment.

3.7 Disclosure Document

- (a) In terms of Regulation 22(3) of the PMS Regulations, a Disclosure Document as specified in Schedule V is required to be filed with SEBI after grant of certificate of registration or whenever any material change is effected, before circulating it to any prospective client and before entering into an agreement with the client. Further, in terms of Regulation 22(4) of the PMS Regulations, the Disclosure Document inter alia includes manner

and quantum of fee, performance of portfolio manager, portfolio risk, conflicts of interest, publishing the same on website, etc.

- (b) Based on the industry representation, AIPAC recommended that calculation of performance using 'Time Weighted Rate of Return' (TWRR) may not be applicable to Co-investment through portfolio management route since such investment does not constitute a portfolio but instead is a single asset vehicle based on investment opportunity. AIPAC further recommended that performance of such Co-investment and contents of Disclosure Document may not be disclosed in public domain since it is linked to investments of AIF, which is a fund based on private placement.

- (c) It is proposed to accept the recommendations of AIPAC. Accordingly, the PMS Regulations may be suitably amended to provide that for Co-investment Portfolio Manager, the calculation of performance using TWRR may not be mandatory. The performance may be calculated and disclosed to co-investors in the manner as agreed between the Co-investment Portfolio Manager and the co-investor. It is further proposed that the requirement of publishing of Disclosure Document on website of the Co-investment Portfolio Manager may not be applicable.

3.8 Requirements for consideration of application for registration

- (a) Requirement of net worth
 - i. In terms of Regulations 7(2)(g) and Regulation 9 of PMS Regulations, a Portfolio Manager is required to have a net worth of not less than INR 5 crore. AIF Regulations do not prescribe any minimum net-worth requirement for the Manager.

 - ii. Based on representation of the industry, AIPAC recommended that the requirement of minimum net-worth for Managers providing Co-investment services through portfolio management route appear to be onerous and may be relaxed.

- iii. The Manager/Sponsor of Category I and II AIFs is required to maintain a continuing interest in the AIF of not less than 2.5% of the investible funds or INR 5 crore, whichever is lower in the form of investment in the fund. Accordingly, the capabilities of the Sponsor/Manager are taken into consideration while granting registration as AIF. In this backdrop, stipulating a requirement of net worth of INR 5 crore on Co-investment Portfolio Manager may be onerous, as observed by AIPAC.
 - iv. It is proposed that recommendation of AIPAC in this regard may be accepted. Accordingly, the PMS Regulations may be suitably amended to specify that the requirement of minimum net-worth may not be applicable to Co-investment Portfolio Manager.
- (b) Appointment of principal officer, compliance officer and additional employee
- i. Regulation 7(2)(c) and 7(2)(d) of the PMS Regulations specify the conditions for consideration of application including, inter alia, appointment of compliance officer and principal officer for seeking registration as Portfolio Manager. The principal officer is required to have professional qualification, work experience and NISM certification as specified in the PMS Regulations and is responsible for decisions for the management of funds and securities, administration of portfolio of the client and other operations of the Portfolio Manager. Further, the compliance officer is responsible for monitoring of all compliances. In terms of Regulation 7(2)(e) of PMS Regulations, in addition to the principal officer and compliance officer, a Portfolio Manager is required to have at least one person with educational qualification and work experience as specified in the regulations.
 - ii. In terms of AIF Regulations, the Manager is responsible for every decision of the AIF. In this regard, one of the eligibility criteria as specified under Regulation 4(g) of AIF Regulations is that at least one

member of the key investment team of the Manager should meet the requirements of experience and professional qualification, which can also be fulfilled by the same personnel.

- iii. The criteria for experience and qualification for the key investment team of the Manager, as prescribed in the AIF Regulations, is not identical to the experience and qualification criteria specified for principal officer in the PMS Regulations. Therefore, a Co-investment Portfolio Manager may have to appoint an additional personnel fulfilling the criteria for principal officer specified under PMS Regulations for the functions which are already fulfilled by the key investment team of the Manager.
- iv. Based on the representation of the industry, AIPAC recommended that considering that the Manager has a key investment team which performs all fund management related operations and that the same investors shall be clients for Co-investment and that the Manager will not be taking any fresh investment decisions, fulfilment of criteria for experience and qualification by the Manager under AIF Regulations may be deemed sufficient for providing Co-investment through portfolio management route and that the requirement of appointment of compliance officer, principal officer and additional employee may be relaxed.
- v. It is proposed that while relaxation in appointment of principal officer for Co-investment Portfolio Manager, as recommended by AIPAC, may not be accepted. However, the criteria for experience, qualification and certification of principal officer may be relaxed provided that any one member of the Key Investment Team of the Manager, who fulfils either of the criteria, viz. experience or professional qualification, as specified in Regulation 4(g) of AIF Regulations, may be designated as principal officer of Co-investment Portfolio Manager.
- vi. The PMS Regulations specify that the compliance officer shall be responsible for monitoring and compliance and shall immediately and

independently report to SEBI any non-compliance observed by him. The PMS Regulations also specify that the role of compliance officer shall not be assigned to the principal officer. Considering that there is no requirement to appoint a compliance officer under AIF Regulations, a Co-investment Portfolio Manager may have to appoint an additional personnel as compliance officer for the limited purpose of Co-investment.

- vii. It is proposed that while relaxation in appointment of compliance officer for Co-investment Portfolio Manager, as recommended by AIPAC, may not be accepted, the requirement of compliance officer to be distinct from principal officer may be relaxed and Co-investment Portfolio Manager may be allowed to appoint any personnel including the principal officer, as the compliance officer.
- viii. It is further proposed that the recommendation of AIPAC with regards to appointment of additional employee may be considered and PMS Regulations may be suitably amended to specify that the requirement of additional employee may not be applicable for Co-investment Portfolio Manager.

3.9 Change in application format for grant of certificate

- (a) The format for application for grant of registration to act as Co-investment Portfolio Manager shall also require modification. Accordingly, it is proposed that the format as specified for Form A under Regulation 4(1) of the PMS Regulations, may be suitably amended for applications for fresh registration as Portfolio Managers, for applicants who intend to act only as Co-investment Portfolio Managers.

3.10 The proposed amendments to the PMS Regulations and the AIF Regulations may be made applicable from the thirtieth day of its publication in the official gazette.

3.11 Manner of undertaking Co-investment portfolio management services

- (a) The Co-investment portfolio management services may be provided in the following manner:
- (i) A Portfolio Manager who is also a Manager of AIF and intends to offer Co-investment services through portfolio management route, may do so under prior intimation to SEBI.
 - (ii) The Manager of an AIF may seek fresh registration from SEBI as a Portfolio Manager who intends to offer only Co-investment services through portfolio management route. Further, such Co-investment Portfolio Manager desirous of offering portfolio management services other than Co-investment, may be permitted to do so subject to compliance with all provisions of the PMS Regulations and with the prior approval of SEBI.
- (b) The proposal at para 3.11(a) and modifications to existing circulars issued under the PMS Regulations and the AIF Regulations including modalities with respect to appointment of custodian for the Manager, obligations and responsibilities, change in control, performance reporting, fees and charges, etc. for Co-investment Portfolio Manager, may be implemented by way of issuance of circular.

4. Proposals

4.1 The Board may consider and approve the proposals at paragraphs 3.1(d), 3.1(e), 3.1(f), 3.2(c), 3.3(c), 3.4(c), 3.5(d), 3.5(e), 3.5(f), 3.6(c), 3.7(c), 3.8(a)(iv), 3.8(b)(v), 3.8(b)(vii), 3.8(b)(viii), 3.9(a) and 3.10. Draft amendment to the SEBI (Portfolio Managers) Regulations, 2020, and the draft notification for the proposed amendment are placed at **Annexure A1** and **Annexure A2** respectively. Draft amendment to the SEBI (Alternative Investment Funds) Regulations, 2012, and the draft notification for the proposed amendment are placed at **Annexure B1** and **Annexure B2** respectively.

4.2 The Board is requested to consider and approve the proposed amendments to the SEBI (Portfolio Managers) Regulations, 2020 and the SEBI (Alternative Investment Funds) Regulations, 2012 and authorize the Chairman to make such necessary consequential or incidental changes to the SEBI (Portfolio Managers) Regulations, 2020 and the SEBI (Alternative Investment Funds) Regulations, 2012 and take consequent steps, as may be deemed appropriate, to give effect to the decision.

Annexure A1

Amendment to SEBI (Portfolio Managers) Regulations, 2020 shall be notified after following the due process.

Annexure A2

Amendment to SEBI (Portfolio Managers) Regulations, 2020 shall be notified after following the due process.

Annexure B1

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

Annexure B2

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