भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

**Consultation Paper on review of Regulation 17 (a) of SEBI (AIF) Regulations, 2012, with the objective of Ease of Doing Business**

## 1. Objective

The objective of this consultation paper is to seek comments / views / suggestions from public on the proposals to allow more holdings in listed debt below a certain rating considering the possible shrinking of the universe of investment opportunities in unlisted debt securities pursuant to the recently introduced Regulation 62A of SEBI (LODR) Regulations, 2015.

## 2. Background

2.1 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."*

2.2 SEBI, vide clause 11.1.5 of SEBI Master Circular dated July 31, 2023 for AIFs, has clarified that with respect to Regulation 17(a) of the AIF Regulations, the term 'primarily' is indicative of where the main thrust of Category II AIFs ought to be. The investment portfolio of a Category II AIF ought to be more in unlisted securities as against the aggregate of other investments. Accordingly, Category II AIFs are required to invest more than 50% of the investible fund in unlisted securities.

2.3 As per Regulation 2 (1) (i) of AIF Regulations, 2012, "debt fund" has been defined as "*an Alternative Investment Fund which invests primarily in debt securities of listed or unlisted investee companies or in securitized debt instruments as per the stated objectives of the Fund*." Therefore, regulatory provisions provide for AIFs to invest primarily in debt securities.

2.4 With respect to investing in debt securities by AIFs, reference is drawn to the recently introduced Regulation 62A of SEBI (LODR) Regulations, 2015 - Listing of subsequent issuances of non-convertible debt securities *(hereinafter referred to as "LODR amendments")* -

*a) 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).*

*b) 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).*

*c) 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.*

2.5 In this context, SEBI has received representations from AIF industry association and from funds which predominantly invest in debt securities, highlighting the following concerns:

a) Pursuant to aforementioned LODR amendments, the entities that had issued listed Non-Convertible Debentures (NCDs) on or before 1st January 2024, would not be eligible to issue any unlisted NCDs till even one listed NCD is live. Regulation 17(a) of the SEBI (AIF) Regulations, 2012 mandates Category II AIFs to invest primarily in unlisted securities.

The aforesaid SEBI LODR amendments could adversely impacted the availability of unlisted debt securities for AIFs, thereby, shrinking the investment universe. Consequently, adhering to the aforesaid AIF regulation may become challenging for Category II AIFs.

b) Further, the debt securities of investee companies which are issued on or after January 01, 2024 and are currently unlisted, would also be mandatorily required to be listed by the investee companies at any time subsequently, in case such investee company propose to list any one of their debt securities in future (in light of Regulation 62A (3) of SEBI LODR Regulations). In light of the above, while a Category II Debt Fund may have invested in unlisted debt securities, the same may subsequently be mandatorily required to be listed by the investee companies. The above provision is beyond the control of the Category II AIFs and may be considered as onerous compliance.

2.6 The impact of LODR Amendments is as under:

a) A listed entity, having outstanding listed debt securities, will only be able to issue listed debt securities from January 01, 2024 onwards.

b) Any outstanding unlisted debt security, issued pursuant to January 01, 2024, may require to be listed in terms of Regulation 62A (3) of SEBI (LODR) Regulations, 2015, if the issuer lists any of the debt security on stock exchange(s) in future subsequent to issue of such unlisted debt security.

2.7 Therefore, the universe of investment opportunities in unlisted debt securities may possibly shrink in future for AIFs for making fresh investments.

2.8 Since the aforesaid concerns pertain mainly to unlisted debt securities investments, the periodic data reported by AIFs to SEBI (as on September '24) was analyzed to understand the focus of investment portfolios of Category II AIFs who invest in debt securities. The following has been observed:

**Table 1: Details Cat-II schemes having investment in debt securities**

| **Total Schemes (Cat II)** | 1383 |
|---|---|
| *Schemes having investment in debt securities* | 330 |
| *Schemes having > 90% of total investment in unlisted debt securities* | 147 |
| *Schemes having >75% of total investment in unlisted debt securities* | 165 |
| *Schemes having >50% of total investment in unlisted debt securities* | 192 |

2.9 It may be observed that there are 192 schemes of Category II AIFs, which have invested more than 50% of their investment in unlisted debt, and may be considered in line with the definition of 'debt funds' as stated in AIF Regulations, 2012.

Therefore, it may be concluded that prospective investments of debt fund schemes which significantly invest portion of their investment in unlisted debt securities, may be impacted due to a possible shrinking of universe of investment opportunities in unlisted debt securities in future due to compliance with the LODR amendments as mentioned at Para 2.4 above. It may, however, be pertinent to highlight that the extent of such possible shrinkage is contingent on investee company (s) preference for listing debt securities, and hence un-ascertainable at the moment.

## 3. Issues under consideration

3.1 The industry representation was perused and based on internal deliberation, it was viewed that the concerns raised by the industry merit consideration.

3.2 By the virtue of being closed ended funds and with the mandate of primarily investing in unlisted securities, Cat II AIFs assume both liquidity risk and Credit risk. By assuming such risk, AIFs play a crucial role in providing much needed capital to industries that may not have access to traditional source of funding or Companies that are not at a stage of their lifecycle to make a public offering.

3.3 With the aforementioned amendment in LODR, and considering that there may be a shrinkage of investment opportunities in unlisted debt securities universe, it merits consideration that the scope of Cat II AIFs to invest 'primarily' in unlisted securities (>50%) may be expanded to listed debt securities also. However, the same may be enabled in such a manner that Cat II AIFs still assume the due credit risk in the ecosystem.

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

3.5 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 more than 50% of their invisible corpus in designated securities (currently unlisted securities) may also be met by investments in listed debt securities having credit rating 'A' or below.

3.6 The matter 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, since a parameter based on private placement of listed debt securities does not necessarily reflect/align with the role envisaged for Category-II

AIFs as given at para 3.2 above, it is viewed that such a parameter may not be considered for devising the criteria for investment by Category II AIFs.

## 4 Proposals for consideration

Based on the recommendations of AIPAC and internal deliberations, public comments are sought on the following proposal:

| ***Proposal 1**:* |
| --- |
| *Category II Alternative Investment Fund to invest more than 50% of their total investible funds in unlisted securities, and/or listed debt securities having credit rating 'A' or below, directly or through investment in units of other AIFs.* |

## 5. Public comments

5.1 Considering the implications of the aforementioned matters on the market participants, public comments are invited on the above-detailed proposals. The comments/ suggestions should be submitted latest by February 28, 2025, through the following link:

https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes

5.2 Any technical issue in submitting your comment through web based public comments form, may be communicated through email to afdconsultation@sebi.gov.in with a subject: *"Consultation Paper on review of Regulation 17 (a) of SEBI (AIF) Regulations, 2012, with the objective of Ease of Doing Business"*.

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