

CIRCULAR

SEBI/HO/AFD/PoD1/CIR/2024/027

April 26, 2024

To,

All Alternative Investment Funds

Sir / Madam,

Sub: Framework for Category I and II Alternative Investment Funds (AIFs) to create encumbrance on their holding of equity of investee companies

1. To provide ease of doing business and flexibility to Category I and II AIFs to create encumbrance on their holding of equity in investee companies to facilitate raising of debt by such investee companies, SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”) have been amended and notified on April 25, 2024. Copy of the notification is available at [link](#).
2. Accordingly, in terms of provisos to Regulation 16(1)(c) and 17(c) of AIF Regulations, Category I and Category II AIFs may create encumbrance on equity of investee company, which is in the business of development, operation or management of projects in any of the infrastructure sub-sectors listed in the Harmonised Master List of Infrastructure issued by the Central Government, only for the purpose of borrowing by such investee company and subject to such conditions as may be specified by the Board from time to time.
3. In this regard, the following conditions are specified:
 - 3.1. Existing schemes of Category I or Category II AIFs who have not on-boarded any investors prior to April 25, 2024, may create encumbrance on equity of investee company for the purpose of borrowing of the said investee company as specified in para 2 above, subject to explicit disclosure with respect to creation of such encumbrance in this regard and disclosure of associated risks in their Private Placement Memorandums (PPMs).
 - 3.2. Any encumbrances already created by a scheme of Category I or Category II AIF prior to April 25, 2024, on the securities of investee company for the purpose of borrowing of such investee company, may continue if such encumbrances were created after making an explicit disclosure in the PPM of the scheme.

- 3.3. In case such encumbrances were created by a scheme of Category I or Category II AIF without making an explicit disclosure in the PPM -
- 3.3.1. such encumbrances may be continued with, only if the encumbrances were created on securities of investee company as stated in para 2 above, and consent of all investors in the scheme of the AIF is obtained to this effect latest by October 24, 2024. If consent of all investors is not obtained within the aforesaid time period, the encumbrances shall be removed latest by January 24, 2025.
- 3.3.2. such encumbrances may not be continued with, if the encumbrances were created on securities of investee company other than as stated in para 2 above. Such encumbrances on securities of the investee company shall be removed latest by October 24, 2024.
- 3.4. Category I or Category II AIFs shall ensure that the borrowings made by the investee company against the equity investments encumbered by the AIFs are utilised only for the purpose of development, operation or management of investee company as stated in para 2 above, and not utilised otherwise including to invest in another company. The aforesaid limitation on usage of borrowing shall be included as one of the terms of the investment agreement entered between the AIF and the investee company.
- 3.5. The duration of encumbrance created on the equity investments shall not be greater than the residual tenure of the scheme of the Category I or Category II AIFs.
- 3.6. Any Category I or Category II AIF with more than 50% foreign investment or with foreign sponsor/ manager or with persons other than resident Indian citizens as external members in its investment committee which is set up to approve its decisions, shall ensure compliance with para 7.11.2 of RBI Master Direction dated January 04, 2018 on 'Foreign Investments in India', as though the AIF is a person resident outside India.
- 3.7. In case of default by the borrower investee company, Category I or Category II AIF shall ensure that the fund or its investors are not subject to any liability over and above the equity of the borrower investee company encumbered by the AIF.
- 3.8. The aforesaid flexibility of creating encumbrance on equity investment shall not be interpreted as allowing schemes of Category I and II AIFs to extend any form of guarantee for investee company.

- 3.9. Schemes of Category I or Category II AIFs shall not create encumbrance on their investments in foreign investee companies.
4. The pilot Standard Setting Forum for AIFs (SFA) in consultation with SEBI shall formulate implementation standards to ensure that the encumbrance created on equity of investee company by Category I or Category II AIFs, is only utilized for facilitation of debt raising at the infrastructure sector investee company as stated in para 2 above. Managers of such AIFs shall adopt and adhere to such implementation standards.
- Such standards shall be published on websites of the industry associations which are part of the SFA, i.e., Indian Venture and Alternate Capital Association (IVCA), PE VC CFO Association and Trustee Association of India.
5. The trustee/sponsor of AIF, as the case may be, shall ensure that the 'Compliance Test Report' prepared by the manager in terms of para 15.2 of Master Circular No. SEBI/HO/AFD/PoD1/P/CIR/2023/130 for AIFs dated July 31, 2023, includes compliance with the provisions of this circular.
6. The circular shall come into force with immediate effect.
7. This circular is issued with the approval of the competent authority.
8. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.
9. The circular is available on SEBI website at www.sebi.gov.in under the categories "Legal framework - Circulars" and "Info for - Alternative Investment Funds".

Yours faithfully,

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