Cat I & II AIFs can borrow to meet temporary shortfall in investment drawdown

Borrowing/leverage under Reg. 16 (1) (c) and Reg 17 (c)

Existing regulations:
Cat I & Cat II AIF could borrow only for the purpose of meeting day-to-day operational requirements to address short-term liquidity needs;

- for a maximum period of 30 days;
- not more than 4 occasions in a year; and
- not more than 10% investable funds.

What is the change and rationale?
Cat I & II AIFs can borrow temporarily to cover liquidity gaps that may arise due to delays in drawdowns from investors. This will ensure that AIFs don't miss out on the investment opportunities. Definition of Cat II AIF also aligned accordingly.

Limit: SEBI circular has specified following borrowing limits to meet shortfall, which shall be the lower of:

- 20% of the proposed investment amount in investee co.; or
- 10% of the investable funds of the scheme; or
- Net undrawn capital contribution of the investors in the scheme.

Other conditions:

- Disclosure in PPM about intent to borrow in case of shortfall;
- Borrowing permitted only in case of emergency and as a last resort, where drawdown amount not received before date of investment, despite best efforts;
- Cost of borrowing to be charged from the investor who failed to provide drawdown;
- Mechanism cannot be used as a means to provide different drawdown timelines to investors;
- Manager to disclose the details with respect to amount borrowed, terms of borrowing and repayment to all the investors of the AIF/scheme, on a periodic basis;
- 30 days cooling off period between 2 periods of borrowing.
    - calculated from the date of repayment of previous borrowing.

Maximum extension of tenure by Large Value Fund(LVFs)

LVF is an AIF/scheme where each investor is an accredited investor & invests not less than Rs 70 cr.

Existing regulations:
LVFs were permitted to extend tenure of scheme beyond 2 years (upto 2 years in case of other close ended AIF) subject to:

- approval of 2/3rd of the unit holders by value of their investments in the scheme;
- terms of contribution and other documents etc.

What is the change and rationale?

- LVFs are permitted to extend their tenure upto 5 years.
- The flexibility of having no upper limit may result in a close ended fund acquiring the colour of a perpetual fund wherein investments of investors may get locked in for an uncertain period of time.

Impact on existing LVFs:
SEBI circular now requires LVFs with undisclosed tenure or schemes with extension of tenure beyond 5 years in their PPMs to comply with the new extension limit by November 18, 2024 subject to consent of all investors. Such LVFs to update their revised tenure in quarterly report submitted to SI portal for the Dec, 2024 quarter. 'Compliance Test Report' prepared by the manager in terms of Chapter 15 of Master Circular for AIFs to confirm compliance with this circular.

SEBI had issued a CP on May 18, 2023 and the same was approved by SEBI in the BM dated June 27, 2024.

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