

*De Jure*

*May 9, 2020*

**Performance Benchmarking and other recent norms for AIFs**



---

## Overview

Benchmark simply means a point of reference or a threshold against which things are compared. Things are evaluated in light of such 'benchmark'. One gets to see or hear about such benchmarks in varied aspects of life. For instance, there would be 'benchmarks' for companies – the best performing one or the one with best corporate governance practice, in sports – the best sportsman of any given discipline, in investments – the best performing mutual fund or the best investment avenue, the best professional and the list goes on and on. To understand in a lighter sense or rather a realistic one, during ones childhood, one is generally compared with the best performing student in the school or in the class – bet it academics, sports or other extra circular activities. These 'benchmarks' come up for discussions when the performance of any particular thing or person is to be assessed.

Closer to the subject under discussion, it would be worthwhile to consider the illustration of benchmarks in mutual fund industry or qua the stock market performance. Any investor wishing to invest in mutual funds or stock markets, would certainly evaluate its investment options in light of the respective benchmarks. For instance, a mutual fund investor would look for the best performing Large Cap scheme or a Multi cap scheme or a Mid Cap scheme etc. Similarly, a stock market investor would analyze the

performance of the stock market or a particular stock over the years or with global stock markets or the performance in different business or economic cycles etc. The whole point is to invest your hard earned money in the most prudent manner after factoring certain information, though historic in nature, but which nevertheless certainly aids one to gauge the trend. It goes without saying that one would not imagine to suddenly metamorphose into a prophet by doing all the historical number crunching and statistical analysis. Eventually, the benchmarks, as in the context of investments, certainly aids in informed decision making while bearing in mind the calculated risk which any investor is eager to partake.

## Alternative Investment Funds (AIFs) in India



AIFs are privately-pooled investment funds which collect funds from investors, whether Indian or foreign, for investing in accordance with a defined investment policy for the benefit of their investors. There are three different categories of AIFs. In India, the Securities and Exchange

---

Board of India (**SEBI**) governs the AIFs in accordance with the SEBI (Alternative Investment Funds) Regulations, 2012 (**SEBI AIF Regulations**).

SEBI AIF Regulations are based on the premise that AIFs are a high-risk asset class, in which only sophisticated and well-informed investors participate. SEBI AIF Regulations therefore, emphasize on the investors being informed of all material information with regard to the AIFs and whenever any material changes are introduced therein, investor consent is sought prior to executing such changes.

### **SEBI Discussion Paper on Performance Benchmarking for AIFs and standardisation of Private Placement Memorandum (PPMs)**



On December 04, 2019, SEBI, with a view to further introduce reforms in the AIF space, came out with a discussion paper on Performance

Benchmarking for AIFs and standardisation of PPMs wherein SEBI invited comments from public and other stakeholders. Subsequently, after receipt of feedback on the said consultation paper from the public and deliberations in the Alternative Investment Policy Advisory Committee (**AIPAC**), SEBI formalised norms in this respect.

### **SEBI Circular on Performance Benchmarking, standardisation of PPM and Annual Audit by AIFs**

SEBI came out with a circular<sup>1</sup> in February 2020 thereby formalising the framework for performance benchmarking for AIFs. Through the said circular, SEBI has also introduced norms for standardisation of PPM and audit requirements for AIFs, however subject to certain exemptions. This way, SEBI took another step towards reforming the ever evolving regulatory ecosystem of AIFs.

### **Standardisation of PPM**

PPM provides the necessary information that a prospective investor would need to take an informed decision to invest in a particular AIF. Though SEBI AIF Regulations provides a broad set of things that needs to be made a part of PPM, there was never a standard format of a PPM

---

<sup>1</sup> SEBI Circular no. SEBI/HO/IMD/DF6/CIR/P/2020/24 dated February 05, 2020

---

which would provide minimum disclosure requirement. Due to this, different AIFs followed their own way of preparing the PPM. There was a need felt to have a standard format of a PPM, from the point of view of the regulator, AIFs and eventually the investors.



## Standardisation

It is observed that there is significant variation in the manner in which various clauses, explanations and illustrations are incorporated in the PPMs.

Considering the importance of PPM to investors, to ensure that minimum standard of information be available in PPM and to facilitate the processing of AIF applications in a time bound manner, AIPAC recommended that the matter be deliberated with the stakeholders and based on which the aforesaid discussion paper was issued. The said SEBI Circular provides two formats for PPM – one for Category I and Category II AIF and the other format for Category III AIF.

The draft templates for PPM focuses on clarifying the riskiness of investment in AIFs, sequence of presentation of information as well as the list of minimum information to be provided under each heading in the PPM.

### **Glimpse at some clauses of the template PPM**

The PPM template now provides for the elaborate disclosure with respect to the performance of the manager and the previous funds which the manager has been associated with. The template also *inter alia* provides for the governance structure of the AIF comprising Sponsor, Trustee, Manager, Key Investment Team, Investment Committee, Advisory Board and Advisory Committee.

The template PPM also requires disclosures on one of the interesting topics - 'Side Letters' which has been done, to a large extent, in a confidential in nature. The SEBI AIF Regulations do not expressly talk about Side Letters or any embargo on it. However, SEBI has not expressed anything favourable as regards Side Letters since the regulator, in its strict sense, does not permit discrimination amongst the contributors/investors. This is considering that the Side Letters, which are entered by the AIF exclusively with any particular investor/ set of investors – and not all investors of AIF, may potentially contain discriminatory/unfair terms as compared to other investors of the AIF.

---

---

The template PPM states that to the extent the Manager intends to offer side letters to certain categories of investors in the Fund/Scheme, certain disclosures need to be made, such as - Whether any side letters shall be offered, the criteria for offering differential rights through side letters to any investor. To clearly state that terms of side letters shall not have any adverse impact on the economic rights or any other rights of other investors. To clearly state that nothing under the side letters shall alter the rights of the other investors available to them under their respective contribution agreements. List of commercial terms on which differential rights may be offered through side letters. List of non-commercial terms on which differential rights may be offered through side letters. List of terms on which differential rights shall not be offered, including but not limited to preferential exit from fund/scheme, giveback, drawdown etc.

The template PPM also provides discussion on the aspects of Conflict of interest and Fees and expenses amongst other regular chapters.

Part B of the template PPM provides for Supplementary Information i.e. any additional information in relation to the Fund/Scheme, Manager, investment team which does not form part of the standard disclosures and the section-wise supplementary section under the earlier sections, may be indicated in such section.

## Annual Audit of AIF compliance



With a view to ensure compliance with the terms of PPM, it will now be mandatory for AIFs to carry out an annual audit of such compliance. The audit shall be carried out by either internal or external auditor/legal professional. However, audit of sections of PPM relating to 'Risk Factors', 'Legal, Regulatory and Tax Considerations' and 'Track Record of First Time Managers' shall be optional.

The findings of the audit, along with corrective steps, if any, shall be communicated to the Trustee or Board or Designated Partners of the AIF, Board of the Manager and SEBI.

## PPM vis-à-vis Contribution Agreement

The terms of contribution or subscription agreement, shall be aligned with the terms of the PPM and shall not go beyond the terms of the PPM.

---



---

Due to performance benchmarking of the AIFs, information with respect to performance of AIF shall be available through authenticated sources and the investors can actually make an informed decision. This is akin to that of Mutual Funds where the performance (or non-performance of the Fund Manager) is there out for everyone to see. The other way to look at it is that the fund managers of AIF would be now under more glare and subject to good scrutiny as the performance would be duly recorded for the prospective investors to examine. Availability of performance records enables the investor to indulge in comparisons before taking the investment plunge.

Based on the request of the industry, it was considered appropriate that an industry benchmark be developed to compare the performance of AIF industry against other investment avenues, as also global investment opportunities.

As the industry needs the flexibility to showcase its performance based on different criteria and benchmarking of performance of AIFs will help investors in assessing the performance of the AIF industry. Accordingly, SEBI has decided to introduce the following:

- a) Mandatory benchmarking of the performance of AIFs (including Venture Capital Funds) and the AIF industry.
- b) A framework for facilitating the use of data collected by Benchmarking Agencies to provide customized performance reports.



### **Benchmarking agencies and reporting by AIFs**

Any association of AIFs (“Association”), which in terms of membership, represent at least 51% of the number of AIFs, may notify one or more Benchmarking Agencies, with whom each AIF shall enter into an agreement for carrying out the benchmarking process.

The agreement between the Benchmarking Agencies and AIFs shall cover the mode and manner of data reporting, specific data that needs to be reported, terms including confidentiality in the manner in which the data received by the Benchmarking Agencies may be used.

AIFs, for all their schemes which have completed at least one year from the date of ‘First Close’, shall report all the necessary information including scheme-wise valuation and cash flow data to the Benchmarking Agencies in a timely manner. The form and format of reporting shall be mutually decided by the Association and the Benchmarking Agencies.

---

---

If an applicant claims a track-record on the basis of India performance of funds incorporated overseas, it shall also provide the data of the investments of the said funds in Indian companies to the Benchmarking Agencies, when they seek registration as AIF.

In the PPM, as well as in any marketing or promotional or other material, where past performance of the AIF is mentioned, the performance versus benchmark report provided by the benchmarking agencies for such AIF/Scheme shall also be provided. In any reporting to the existing investors, if performance of the AIF/Scheme is compared to any benchmark, a copy of the performance versus benchmark report provided by the Benchmarking Agency shall also be provided for such AIF/scheme.

Associations will need to appoint Benchmarking Agencies and thereafter will set timeline for reporting of requisite data to Benchmarking Agencies by all the registered AIFs. The said SEBI circular provides the operational guidelines for performance benchmarking.

In addition to the standard benchmark report prepared by the Benchmarking Agencies, if any AIF seeks customized performance reports in a particular manner, the same may be generated by the Benchmarking Agencies, subject to certain conditions as stated in the SEBI circular.

Some of the requirements with respect to performance benchmarking shall not apply to Angel Funds registered under sub-category of Venture Capital Fund under Category I - AIF.

### **Conclusion**



With the standardization of PPM, SEBI is trying to ensure that the AIFs disclose at such minimum information which it feels necessary to verify as a regulator and also from the perspective of prospective investors. As far as existing AIFs are concerned, SEBI may seek additional information from them given that SEBI now, by setting such standard templates, has very well sent out a message as to what it expects from AIFs and its management. Going a step ahead, SEBI has indicated its seriousness that AIFs comply with the template PPMs by introducing annual audit of compliance of PPM terms, albeit subject to non-mandatory aspects and exemptions for certain category of AIFs – for reasons quite understandable. Further, the reporting of such audit findings to SEBI would certainly keep the AIF managements always on its toes.

---



---

It is also worthwhile to note about the provision of waiver which an investor may provide in favour of the AIF from the requirement of PPM in the SEBI prescribed template and annual audit of terms of PPM. This acknowledges the fact that the AIF investors are a sophisticated breed different from retail investors and thus the power of waiver to the AIF investors. Thus, SEBI on one hand has tried to provide for minimum disclosures and at the other side provided the option to the AIF investors to waive the same thereby underlining the fact of extent of knowledge, analytical skill and erudition of AIF investors.



Since the onset of the SEBI AIF Regulations, SEBI has, from time to time, strived to reform the AIF space by inculcating the best practices prevalent in other industries or other jurisdictions as well as lessons learnt from various corporate misadventures. The latest attempt in performance benchmarking and PPM standardization seems to be commendable one, especially from the perspective of contributors/ investors who

unquestionably form the very basis and essence of the whole AIF structure.

The need of Performance benchmarking was long felt by AIF investors as they felt the need to have an industry benchmark where they could evaluate the performance by comparing the best performing AIF and in the process have some kind of semblance on the prospects of their investment return. This could provide a 'more organized look' to the AIF realm since there isn't much formally available information to the investor fraternity as regards the AIF performance save and except some privately exchanged statistical data. This should ideally enhance India's reputation amongst global investment fraternity.

SEBI, as a regulator, has been at the forefront in protecting and promoting the interests of investors and shareholders, by virtue of the very statute under which it has been set up. A need was felt for promoting the interests of investors of AIF and addressing their certain concerns. SEBI seems to be certainly acknowledging this need and the stage looks set for more laudable reforms by SEBI.

**Contributed by:**

**Ashish Parwani, Partner:** [ashish@rajaniassociates.net](mailto:ashish@rajaniassociates.net)

**Rajeev Nair, Principal Associate:** [rnair@rajaniassociates.net](mailto:rnair@rajaniassociates.net)

---

---

**DISCLAIMER:**

This Article is meant for information purposes only and does not constitute any legal advice by Rajani Associates or by the authors to the article. The contents of the Article cannot be intended to be comprehensive legal advice and would require re-evaluation based on the facts and circumstances. We cannot assume any legal liability for any errors or omissions. Should you have any queries on any aspect contained in this article, you may contact the author by way of an e-mail or write to us at [editorial@rajaniassociates.net](mailto:editorial@rajaniassociates.net).

---

---

## AREAS OF PRACTICE

| Capital Markets | Private Equity | Mergers and Acquisitions | Corporate Litigation & Arbitration | Projects & Project Finance |  
| Real Estate & Trust | Corporate & Commercial | Banking & Finance | Structuring | TMT | IPR | Employment

---

## DISCLAIMER

This update only contains a summary/ limited description of the topic dealt with hereinabove for general information purposes and should not be construed as a legal opinion or be relied upon in absence of specific legal advice. For further information or legal advice please feel free to contact us.

---

## CONTACT US



# Rajani Associates

simple solutions

**Address:** Krishna Chambers  
59 New Marine Lines  
Churchgate  
Mumbai 400020  
Maharashtra, India  
**Telephone:** (+91-22) 40961000  
**Facsimile:** (+91-22) 40961010  
**Email:** [dejure@rajaniassociates.net](mailto:dejure@rajaniassociates.net)  
**Website:** [www.rajaniassociates.net](http://www.rajaniassociates.net)

---