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Sebi's merchant banker order may stretch new AIF timelines, says industry

Regulator's notification has limited international precedent and is unnecessary, say analysts.

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Sachin P Mampatta | Mumbai Last Updated at August 29, 2021 13:30 IST

A new regulatory requirement for merchant bankers to review alternative investment fund (AIF) documents has rankled an industry already battling challenges caused by the coronavirus pandemic.

An asset manager provides investors details about a new AIF through a private placement memorandum (PPM). It contains fees, investment strategy and other important information. The Securities and Exchange Board of India (Sebi) has asked that merchant bankers vet these documents. The process is similar to how bankers look at details in initial public offer (IPO) documents when a company first sells shares to the public.

The move has limited international precedent and is seen to introduce cause delays for the industry.

"…the involvement of a merchant banker to review the terms of marketing seems unnecessary. It is uncommon globally for even regulators to review the PPM as it is a marketing document, let alone the review process be reposed on bankers," said Nandini Pathak, co-head of fund formation at Nishith Desai Associates.

The requirement would add to the costs of the process and seems excessive in light of the kind of people investing in AIFs, according to Divaspati Singh, Partner, Khaitan and Co.

"Considering that AIFs are meant for sophisticated investors with a minimum entry barrier, this vitiates the entire construct of the regime. Even mutual fund offering documents are not fronted (by merchant bankers)," he said.

The minimum investment in AIFs is one crore rupees. Only accredited investors who have proved high net worth or income can invest lower amounts.

"Such placement memorandum shall be filed with the Board…[through a merchant banker] at least thirty days prior to launch of scheme along with the fees as specified," said the change that Sebi notified on August 13.

"The Board may communicate its comments, if any, to the merchant banker prior to launch of the scheme and the merchant banker shall ensure that the comments are incorporated in the placement memorandum prior to launch of the scheme," it said.

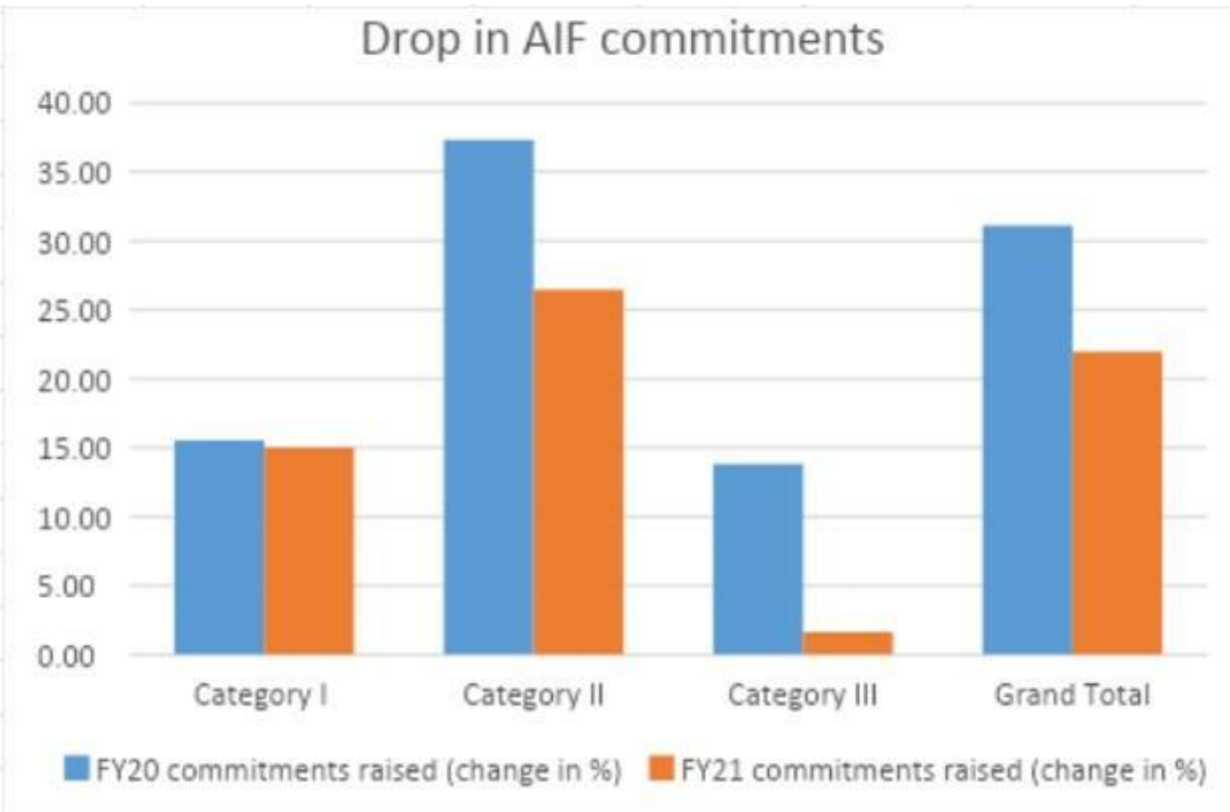
The industry has faced some issues because of the spread of Covid-19. Growth in commitments raised for the AIF industry were down from 31.1 per cent in the previous year to 22 per cent for the financial year ending March 2021 (FY21). The industry has raised Rs 4.5 trillion in cumulative commitments. It has made investments of over Rs. 2 trillion.

Some categories have done worse than others. Category III AIFs, which include hedge funds, have seen commitments increase by only 1.6 per cent in FY21. Category II AIFs, which include private equity funds and distressed asset funds, saw commitments increase by 26.5 per cent during the year. Category I AIFs include subcategories such as infrastructure funds, social venture funds, venture capital funds and schemes investing in small and medium enterprises. Commitments were up 15 per cent.

"The pandemic has already caused commercially painful delays in obtaining AIF registrations and fund raising for domestic managers. Introduction of a market intermediary could swing this either way depending on how efficient the merchant bankers turn out to be, though the market reaction is that it is likely to cause delays. The process has unfortunately not been introduced as time bound," said Pathak of Nishith Desai Associates.

There is little international precedent for this. Mauritius has 'administrator' firms, according to Singh from Khaitan and Co. Such firms help set up, administer and help with the licensing process.

"This is completely different from what Sebi has implemented, since (merchant bankers) in India were originally established for IPOs (and other investment banking transactions) and are not traditionally adept on private equity funds and structures, while the Mauritius administrator firms have been established for the very purpose of fund administration and accounting, thereby their understanding of fund structures is much better," he said.



Note: Shows cumulative figure; Source: Sebi, BS calculations

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