Guidelines for borrowing by Category I and Category II AIFs and maximum permissible limit for extension of tenure by LVFs

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Brief on the Circular

A. Guidelines for borrowing by Category I and Category II AIFs

In terms of Regulation 16(1)(c) and Regulation 17(c) of AIF Regulations, Category I and Category II AIFs shall not borrow funds directly or indirectly or engage in any leverage for the purpose of making investments or otherwise, except for borrowing funds to meet temporary funding requirements and day-to-day operational requirements for not more than thirty days, on not more than four occasions in a year and not more than ten percent of the investable funds and subject to such conditions as may be specified by SEBI from time to time.

In this regard, in order to facilitate ease of doing business and provide operational flexibility, it has been decided to allow **Category I and Category II AIFs** to borrow for the purpose of meeting temporary shortfall in amount called from investors for making investments in investee companies **('drawdown amount').**

- **Category I and II AIFs** must disclose their intention to borrow funds to cover a shortfall in the drawdown amount in the Private Placement Memorandum (PPM) of the scheme. This borrowing is only permitted in cases where investor funds have not been received in time, despite the manager's best efforts.
- Borrowing is allowed only in emergency situations where an imminent investment opportunity is about to close, and the drawdown funds have not arrived from the investor(s). **It is used as a last resort when the manager has exhausted all efforts to collect the delayed funds.**
- The borrowed amount must be within the **lesser of 20%** of the proposed investment, **10% of the investable funds of the AIF's scheme**, or the amount of the commitment pending from other investors (excluding the defaulting investor). This ensures that borrowing is kept within strict limits based on the investment and fund size.
- The cost of the borrowed funds will be charged **solely to the investor(s) who failed to provide the drawdown** amount on time, ensuring that non-defaulting investors are not penalized for delays caused by others.
- After each borrowing, there must be a mandatory **30-day cooling-off period before another borrowing can occu**r. The manager is required to disclose the amount borrowed, terms, and repayment details to all investors periodically, as per the terms of the agreement. This cooling-off period is calculated from the repayment date of the previous borrowing to ensure there are no frequent borrowings.

B. **Maximum permissible limit for extension of tenure by LVFs**

In terms of proviso to Regulation 13(5) of AIF Regulations, a LVF may extend its tenure up to five years subject to the approval of two-thirds of the unit holders by value of their investment in the LVF and the extension in tenure of any existing LVF scheme shall be subject to such conditions as may be specified by SEBI from time to time.

- Existing LVF schemes with an undefined or extended tenure beyond the permissible **five years must align with new requirements by 18th November 2024 and update their tenure in the quarterly SEBI report for Q4 2024.**

- LVF schemes can revise their tenure with the consent of all investors. An undertaking confirming investor consent must be submitted to SEBI by **18th November 2024.**

- The conditions for extending tenure specified in **SEBI's Master Circular for AIFs will no longer apply from the date of this circular.**

- Trustees or sponsors of AIFs must ensure the **'Compliance Test Report' includes adherence to the new provisions as outlined in this circular.**

Impact of the Circular

- Category I and II AIFs can now borrow to cover shortfalls in drawdowns for investment, provided it's disclosed in the PPM and used only in emergencies. This provides greater operational flexibility but limits borrowing to specific conditions.

- The amount borrowed must not exceed 20% of the proposed investment, 10% of investable funds, or the commitment pending from other investors (excluding defaults), ensuring controlled borrowing limits.

- Costs of borrowing are charged to defaulting investors, not affecting others. A mandatory 30-day cooling-off period between borrowings is required to prevent frequent borrowing.

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