Modification in framework for valuation of investment portfolio of AIFs

September 19, 2024

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Background on the Circular

- SEBI amended the **AIF Regulations, 2012 on June 15, 2023, and issued a circular on June 21, 2023**, for a consistent and standardized valuation approach for AIF portfolios.

- As per **Clause 22.1.2 of the Master Circular (May 7, 2024), securities not covered in Clause 22.1.1** must be valued according to guidelines endorsed by an AIF industry association representing at least 33% of SEBI-registered AIFs.

- An eligible AIF industry association endorsed the International **Private Equity and Venture Capital Valuation (IPEV)** Guidelines for portfolio valuation **under Clause 22.1.2.**

- SEBI received representations from the AIF industry on issues regarding the valuation framework, and after considering public comments, AIPAC recommendations, and internal discussions, SEBI made decisions to address these concerns.

Brief on the Circular

- **Clause 22.1.1 of the Master Circular stands modified as under**

  Valuation of securities, other than unlisted securities and listed securities which are non-traded and thinly traded, for which valuation norms have been prescribed under **SEBI (Mutual Funds) Regulations, 1996 ('MF Regulations')**, shall be carried out as per the norms prescribed under MF Regulations

- **The valuation norms for securities which are not covered in Para 22.1.1 of the master circular have been provided in Clause 22.1.2 of the master circular. For the sake of clarity, the same is reproduced as under**

  Valuation of securities which are not covered in para 22.1.1 above, shall be carried out as per valuation guidelines endorsed by any AIF industry association, which in terms of membership represents **at least 33% of the number of SEBI registered AIFs**. The eligible AIF industry association shall endorse appropriate valuation guidelines after taking into account recommendations of Alternative Investment Policy Advisory Committee of SEBI.

  SEBI plans to harmonize valuation norms for thinly traded and non-traded securities across regulated entities by March 31, 2025, to ensure uniform application for AIF portfolio valuations.

- **Clause 22.2.2 of the Master Circular stands modified as under**

Change in valuation methodology/approach to comply with **Clause 22.1 of Master circular for AIFs on 'Standardized approach** to valuation of investment portfolio of AIFs', shall not be construed as **'Material Change'.**

Change in methodology/approach within the valuation guidelines / valuation norms prescribed for AIFs, shall not be construed as a 'Material Change'. However, upon such change, the valuation of the investment carried out based on valuation methodologies / approaches, both old and new, shall be disclosed to the investors to ensure transparency.

- **New sub-clause is inserted in clause 22.3 of the Master Circular**:

Clause 22.3 of the Master Circular lays down the **Eligibility Criteria for an Independent Valuer**. This Circular modifies the said clause by making in addition by way of a sub-class to the same.
The following new sub-clause is inserted in clause 22.3 of the Master Circular:
22.3.4 The eligibility criteria for independent valuer for a partnership entity or company shall be as follows –

- Such entity or company shall be a **'Registered Valuer Entity' registered with IBBI; and**
- The deputed/authorized person(s) of such 'Registered Valuer Entity', who undertake(s) the valuation of investment portfolio of AIFs, shall have a membership of **ICAI or ICSI or ICMAI or a CFA Charter from the CFA Institute.**

- **Reporting of valuation of investments of AIF to performance benchmarking agencies**:

Clause 22.4.1 of the Master Circular casts a duty upon the Fund Manager to report valuation based on audited data of investee companies as on March 31 to performance benchmarking agencies within the specified timeline. The specified timeline **envisaged in the Master Circular was 6 months**, which means Fund Manager were required to submit the valuation report of investee companies on or before 30th September of every financial year. However, the said timeline has been revised in lieu of the changes made pursuant to this circular.

Based on this Circular, Fund Managers will now have **a time period of 7 months to report valuation of investee companies as on March 31st** to the Performance Benchmarking Agencies. As per the revised timeline, Fund Manager can now report the valuation to Performance Benchmarking Agencies **by October 31st of every financial year.**

The trustee/sponsor of AIF, as the case may be, shall ensure that the 'Compliance Test Report' prepared by the manager in terms of **Chapter 15** of the master circular for AIFs, includes compliance with the provisions of this circular

Impact on the Circular

- ✓ The amendments introduce a consistent and uniform approach to valuing AIF portfolios, particularly for thinly traded and non-traded securities. By adopting the International Private Equity and Venture Capital Valuation (IPEV) Guidelines, SEBI enhances credibility, transparency, and comparability, boosting investor confidence and aligning Indian markets with global standards.

- ✓ SEBI's stricter eligibility criteria for independent valuers create a more robust valuation oversight framework. AIFs will face increased costs to comply with these guidelines, but the emphasis on independent, professional valuers ensures higher transparency, accountability, and integrity in portfolio valuation.

- ✓ By extending the reporting deadline for fund managers to submit audited valuations to benchmarking agencies, SEBI reduces the operational pressure on AIFs, allowing for more thorough and accurate reporting. This extension is likely to improve the quality of data submitted, leading to better performance tracking and market benchmarking.

- ✓ SEBI's plan to harmonize valuation norms by March 2025 ensures consistent valuation practices across all SEBI-regulated entities. This move reduces discrepancies between asset classes and investment vehicles, leading to more reliable and comparable market data, which could attract greater interest from global institutional investors.