

ANNEXURE: Clarifications and recommendations - Standardised approach to valuation of portfolio of AIFs

Clause No	Contents of Clause	Comments	Recommendation
3	Valuation Guidelines	Its possible that there could be a conflict between Valuation guidelines of RVO/valuation guidelines Rules 2017 and the IPEV valuation framework/guideline under Cluse 3.1 & 3.2	Its our suggestion that SEBI clarifies that if there is a conflict between IPEV framework valuation principles and the guidelines for valuation by RVO/Valuation Rules, 2017 , the valuers adhere to the principles of IPEV framework for the purpose of valuation of portfolio of AIFs.
3.2	Valuation of securities which are not covered in para 3.1 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.	<p>The Model PPM mandated under the Feb 5, 2020 circular requires the valuation methodology to be described by the Manager. As the industry shifts to the valuation guidelines endorsed by the AIF Association, changes will need to be made to the PPM of all Funds</p> <p>In this regard, clarity must be given that such a change is pursuant to change in Regulations and that Investor consent is not required. <u>This must not be considered as a "Material Change" as per Para 2.5.4 of the SEBI Master Circular on AIFs</u></p> <p>All Investors must be informed about the same by the AIF.</p>	<p>Amendments to the following will be required:</p> <ol style="list-style-type: none"> 1. Para 2.5.4 of the SEBI Master Circular on AIFs (corresponding to SEBI circular No. CIR/IMD/DF/14/2014 dated June 19, 2014 and SEBI Circular No. CIR/IMD/DF/16/2014 dated July 18, 2014.) 2. Para 6.2 of the SEBI Circular SEBI/HO/AFD/PoD/CIR/2023/97 titled "Standardised approach to valuation of investment portfolio of Alternative Investment Funds (AIFs)" 3. Model PPM issued by SEBI
5	Further, in terms of Regulation 23(6) of AIF Regulations, Manager shall be responsible for true and fair valuation of the investments of the scheme of the AIF. In terms of proviso to aforesaid Regulation, in case the established policies and procedures of valuation do not result in fair and appropriate valuation, the Manager shall deviate from the established policies and procedures in order to value the assets or securities at a fair value and document the rationale for such deviation.	<p>Pursuant to this circular, the Manager will now be obligated to follow the valuation methodology prescribed by the AIF Industry Association.</p> <p>If the Manager discovers that the valuation methodology prescribed does not result in a true and fair valuation and is obligated to deviate from the same, is investor consent required prior to such deviation?</p> <p>Should there be prior approval from the investors for the manager to deviate or can the manager apply its discretion to arrive at fair valuation and then communicate to the investor, providing comprehensive details on the mechanism applied, reasons, etc.</p> <p>This is crucial given Para 6.2 of this Circular</p>	The procedure to be followed by the Manager pursuant to Para 5 must be elaborated upon to ensure there isn't ambiguity in terms of its operationalization
6	Responsibility of manager of AIF with regard to valuation of investments of AIF	Requirement of Para 6.1, 6.2, & 6.3 of the Circular needs to be exempted for investments where AIFs/Manager follow guidelines as per Para 3.1 of the Circular as AIFs have no direct role to play in the FV of the securities	Clause 6.1, 6.2, 6.3 should not apply to securities covered under 3.1
6.2	Any change in the methodology and approach for valuation of investments of scheme of AIF, shall be construed as material change significantly influencing the decision of the investor to continue to be invested in the scheme of the AIF and the AIF shall adhere to process to be complied with in such cases as mentioned in SEBI circular No. CIR/IMD/DF/14/2014 dated June 19, 2014 and SEBI Circular No. CIR/IMD/DF/16/2014 dated July 18, 2014.	<p>Within the framework established by IPEV, various valuation methods are available for appraising a portfolio company. These methods encompass techniques such as Discounted Cash Flow (DCF), Price of Recent Investment (PORI), Comparative Companies Transaction Multiple (CCTM), Comparable, Book Value, and Earnings Capitalization etc. The choice of method hinges on several factors, including the company's operational stage, the sector it operates in, and the professional valuer is competent in making an informed selection of adoption a valuation method.</p> <p>As a company evolves, it undergoes valuation using different methods throughout its lifespan. In its early stages, for instance, valuation may involve cost-based assessments, PORI-based appraisals, or reliance on Comparative Companies Transaction Multiples. As the company's growth matures, the DCF method may become more applicable. It's important to note that all these methods are in accordance with the IPEV framework. Consequently, the valuer must make a determination regarding the appropriate method to use for a particular year, within a specific sector, and considering the company's stage of development, drawing from the accepted methods outlined in the IPEV framework for that asset class. Such a decision should not be regarded as material change</p> <p>It is essential to emphasize that AIFs consistently adhere to the fair value principle when valuing underlying investments. Nevertheless, the valuation approach may adapt on a yearly basis, contingent upon specific circumstances and with full justification. Such flexibility is a standard practice in the industry.</p>	<p>Modifications to valuation methods within the scope of the IPEV framework should not be automatically deemed as material changes that significantly impact investors' decision-making. Such a stance could discourage Alternative Investment Funds (AIFs) from to follow right valuation approach.</p> <p>The current language is overly broad in its scope, and the objective should be to identify changes that fall outside the prescribed parameters of the valuation guidelines. It is only in these limited instances that a change should be classified as material. Therefore, the proposed language for this clause should read as follows:</p> <p>"Any alteration in the methodology and approach employed for valuing any of the investee companies or portfolio company or an asset class, which deviates from the IPEV framework and the guidelines issued by the association pursuant to Clause 3.2, shall be deemed a 'Material change'."</p> <p>Clarity is required on the following:</p> <ol style="list-style-type: none"> 1. Whether the adoption of the valuation methodology under this Circular would constitute "Material changes" as mentioned in in SEBI circular No. CIR/IMD/DF/14/2014 dated June 19, 2014 and SEBI Circular No. CIR/IMD/DF/16/2014 dated July 18, 2014 ?

6.2 (Continued)		<p>Even with the obligation of the Manager under Regulation 23(5) of the AIF Regulations, the valuation methodology is chosen by the Valuer taking into account the portfolio company, its financial and operating history, macro-conditions, etc. A change in the methodology may be undertaken by the Valuer and only intimated to the Manager. <u>As valuation operates similar to an audit in terms of an independent function, the Manager does not have the ability to influence the kind of methodology adopted by the Valuer. Thus as in the case of audit the method/process is left to an auditor, the choice of the valuation method is to be left to the professional valuer</u></p> <p>A Material Change must be a change by the Manager or AIF of established practises. A change by a third party professional like a Valuer should not expose the Manager or AIF to the mechanism stated in circular No. CIR/IMD/DF/14/2014 dated June 19, 2014 and SEBI Circular No. CIR/IMD/DF/16/2014 dated July 18, 2014</p>	<p>2. IF the Valuer changes the valuation methodology and not the Manager, would it constitute "Material changes" as mentioned in in SEBI circular No. CIR/IMD/DF/14/2014 dated June 19, 2014 and SEBI Circular No. CIR/IMD/DF/16/2014 dated July 18, 2014 ?</p>
6.3	<p>Para 6.3. of the Circular states that the manager shall disclose the following as part of changes in PPM to be submitted annually to SEBI and investors:</p> <p>6.3.1. Details of changes in the valuation methodology and approach, if any, for valuation of each asset class of the scheme of the AIF;</p> <p>6.3.2. Details of changes in accounting practices/policies, if any, of the investee company and the scheme of the AIF</p> <p>6.3.3. Details of impact of the aforesaid changes in terms of valuation of the investments of the scheme of the AIF.</p>	<p>The PPM as a document does not contain details of the Portfolio Companies or their policies. Portfolio construction can only be undertaken once the PPM is approved.</p> <p>Further the the section encompassing valuation or valuation methodologies is not present in the Private Placement Memorandum. PPM of the AIFs never capture the details of accounting policies and practices of the investee company. Therefore, for reflecting the changes, there will not be any benchmark or criteria</p> <p>Also as regards to changes in the accounting practices/policies of the investee companies and identifying changes and their subsequent impact on valuation is a complex task under these circumstances. This challenge intensifies when Alternative Investment Funds (AIFs) hold a minority stake in the investee company, which means they often lack access to comprehensive information necessary to quantify the effects of changes in the valuation policy. Furthermore, considering the multitude of investee companies, it is practically infeasible for AIFs to keep pace with every change in accounting policies and practices. To assess the impact, AIFs may need to value investments based on both the prior and current methodologies, approaches, and accounting policies and practices, given the constraints of data availability and information accessibility.</p> <p>Consequently, it becomes exceedingly impractical, or almost impossible, for AIFs to fully comply with Clause 6.3.2 & 6.3.3</p>	<p>The PPM does not contain details of the accounting policies of portfolio companies as the portfolio is not constructed at the point of filing the PPM. The Annual report to be filed by the AIF, which also needs to contain details of the portfolio companies, may be more appropriate place for changes related to the accounting policies/practices of Portfolio Companies, to the extent available with AIF.</p> <p>These changes may not have an impact on the valuation of the investments. Hence the phrase "if any", which is included in Paras 6.3.1 and 6.3.2 must also be included in Para 6.3.3</p> <p>Please consider the insertion of the phrase "if any", in 6.3.3, similar to paras 6.3.1 and 6.3.2</p>

8.3.1	<p>The independent valuer is a valuer registered with Insolvency and Bankruptcy Board of India and has membership of Institute of Chartered Accountants of India or Institute of Company Secretaries of India or Institute of Cost Accountants of India or CFA Institute;</p>	<p>The independent valuer is a valuer registered with the Insolvency and Bankruptcy Board of India or possesses membership in one of the following professional bodies: the Institute of Chartered Accountants of India, the Institute of Company Secretaries of India, the Institute of Cost Accountants of India, or the CFA Institute.</p> <p>Observation:</p> <p>a) The requirement for dual membership, i.e., being a Registered Valuer (RV) and holding qualifications in CA/CS/ICWA, has the potential to disqualify numerous registered valuers. This is because many registered valuers may not possess qualifications in CA/ICWA/CS. Registered valuer entities often operate as distinct legal entities within larger professional services firms. These entities may have partners who do not hold CA/CS/ICWA qualifications. These non-CA/CS/ICWA partners play a crucial role as registered valuers, particularly in the valuation of assets such as land & buildings and plant & machinery.</p> <p>b) The eligibility criteria for RV accreditation, on a stand alone basis, is quite comprehensive, placing significant emphasis on education and practical experience in the relevant field before accreditation as an RV is granted.</p> <p>c) It's worth noting that SEBI (Securities and Exchange Board of India) has acknowledged the utilization of registered valuers in various regulations without imposing a specific requirement for dual membership under IBBI (Insolvency and Bankruptcy Board of India) and other professional institutes. This recognition is evident in multiple instances, for example:</p> <ul style="list-style-type: none"> - The Master Circular on (i) Scheme of arrangement by Listed entities and (ii) Relaxation under sub-rule (7) of rule 19 of the Securities Contracts (Regulation) Rules, 1957, dated 20 June 2023 [paragraph 4 – Valuation Report; clause (a)] - Infrastructure Investment Trusts Regulations, 2014 (updated February 2023) [definition of 'Valuer,' Regulation 9 – Rights and Responsibilities of Trustee, and Regulation 10 – Rights and Responsibilities of Investment Manager] - Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 [Definition of Valuer, para 163 (3), para 165, and para 166A] 	<p>We propose a modification to the requirement, advocating for a single membership with registration under IBBI. We suggest eliminating the additional necessity for holding membership with the Institute of Chartered Accountants of India, the Institute of Company Secretaries of India, the Institute of Cost Accountants of India, or the CFA Institute.</p> <p>Therefore, we kindly request the removal of the following clause from 8.3.1: "and has membership of Institute of Chartered Accountants of India or Institute of Company Secretaries of India or Institute of Cost Accountants of India or CFA Institute."</p>
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8.3.3	Any other criteria as may be specified by SEBI from time to time.	<p>Under this clause we submit the following comments</p> <p>1. SEBI registered Category-I Merchant Bankers</p> <ul style="list-style-type: none"> - There are several instances Merchant Bankers being eligible for valuations under a specific Act (Income Tax Act, FEMA Regulations, Companies Act 2013), including various SEBI regulations; - Merchant bankers are registered with and regulated by SEBI directly, facilitating SEBI's governance and regulations on such market participants; - The amount of well-established and well-capitalised Category-1 Merchant Bankers would mean that a limited list of members would be added to the eligible participants to carry out portfolio valuation; <p>2. It is important to highlight that the prevailing RV regulations under IBBI do not permit non-residents to become registered valuers. Consequently, the entire Alternative Investment Fund (AIF) industry faces the potential drawback of missing out on the extensive expertise offered by prominent foreign specialists in this field. As a result, even well-established multinational corporations with considerable experience in this domain may not meet the stringent eligibility criteria outlined in the RV framework.</p> <p>A substantial volume of foreign capital finds its way into India through domestic Alternative Investment Funds (AIFs) and international (global/offshore) funds managed by multinational managers. These managers often have global agreements with firms that would not meet the criteria set by the Insolvency and Bankruptcy Board of India (IBBI). Consequently, this situation risks forfeiting a substantial pool of expertise among service providers effective November 1, 2023. Such a loss would pose considerable risk to current and future processes, particularly in terms of delivering meaningful and reliable data to those entities obligated to adhere to globally accepted standards, such as IPEV.</p> <p>Despite the growing influx of foreign capital into India's economy and the commendable strides made by the RV framework, there exists a palpable risk of confining the market solely to domestic individuals and entities. Such a scenario could entail a significant loss of expertise, independence, and profound experience from multinational entities operating in this domain. These entities could otherwise draw upon their networks in developed markets with advanced valuation practices.</p> <p>Valuers already appointed by funds that have garnered capital from large, sophisticated investors, and where these valuers have been chosen in accordance with their LP-GP Agreement, face a noteworthy challenge.</p>	<p>1. We therefore suggest for SEBI to consider adding "Category I Merchant Bankers" as persons who can qualify as valuers of the portfolio of an AIF</p> <p>2. For Large Value Funds, let the Investors decide whom they want the valuers to be and not necessarily what is defined under 8.3.1 and 8.3.2. And the LP -GP agreement will decide who the valuer is and will be informed to SEBI either in the PPM or otherwise. This proposal would encompass a substantial number of leading audit firms, international property consultants, and specialized advisors. These entities, although not currently categorized as Category 1 Merchant Bankers, boast significant experience in the field of portfolio valuation.</p>
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9.1	<p>Manager of AIF shall ensure that a specific timeframe for providing audited accounts by the investee company to the AIF is included as one of the terms in subscription agreement / investment agreement with the investee company, so as to enable AIFs to report valuation based on audited data of investee companies as on March 31 to performance benchmarking agencies within the specified timeline of six months.</p>	<p>The requirement to base valuations on the audited financial statements of investee companies, although well-intentioned, carries unintended consequences. This proposed mandate places an obligation on AIF managers regarding a variable they cannot directly control, potentially exposing them to legal repercussions and penalties. Moreover, it's important to note that the IPEV framework does not prescribe that valuations must be based on audited financial statements of investee companies.</p> <p>Each portfolio company may complete its audited financials for March 31 within a period of 6 months as per companies act. If these audited financials are to be considered for the valuation purposes, then the valuation & audit of Fund will get delayed beyond 30th Sept (which is the time limit for completion of AIF audit under AIF Regulations). Thus the AIF manager will be at the risk of not complying with the AIF Regulations.</p> <p>Also, many AIFs are required to complete their audit process within a period of 3 to 4 months from March 31 as per their internal management time lines/listing regulations and will not be able to do so if they have to wait for audited statements of their portfolio companies</p> <p>Investors also expect that the audited financials of AIFs are received within a short period of time post 31 March, so that they can review it on a timely basis.</p> <p>While the industry is more than willing to incorporate the obligation of audited financial statements into shareholder agreements for investments done after the circular comes into effect, AIF managers should not be subjected to penalties or legal actions if these audited statements are not received within the expected timeframe.</p> <p>The filing of Form 64C/64D under Income Tax by 30th June is contingent upon the audited statements of the AIF, which necessitates the completion of valuations for investee companies. Valuers must finalize their assessments before the audit concludes. Demanding that valuations be based on the audited statements of investee companies could result in the AIF's non-compliance with the requirements of the Income Tax Act, 1961.</p> <p>It's worth noting that the IPEV Valuation guidelines acknowledge the limited role of audited financials for startups. In the context of applying a multiple to maintainable earnings or revenue, it's crucial for the Valuer to have confidence in the reliability of earnings/revenue figures. While this might seem to favour the use of audited historical figures over unaudited or forecasted ones, it's essential to recognize that value inherently involves forward-looking considerations. Quoted markets often place more emphasis on 'current' and 'forecast' multiples rather than 'historical' ones.</p> <p>The condition for adding the requirement to furnish audited financial statements should apply exclusively to new investments and not to existing ones. This distinction is crucial because if this provision is absent in the existing transaction documents, amending all the past investment agreements can become an arduous task.</p>	<p>To provide clarity on the scope of adding provisions mandating the submission of audited financial statements within the subscription agreement or investment agreement, this requirement should exclusively pertain to new investments made after the date of this circular.</p> <p>This distinction is essential to ensure that the condition for providing audited financial statements is not imposed retroactively on existing investments. Attempting to amend all existing investment agreements to include this provision could pose considerable challenges.</p> <p>Delete requirement of linking audited financials of the Fund, with valuation based on audited financials of portfolio companies as at March 31 of the same year.</p> <p>No punitive measures should be taken against the Manager, AIF, or Trustee in the event that a portfolio company fails to submit its audited financials within the stipulated timeframe. Instead, any such failure by a portfolio company could be promptly reported to investors as part of the AIF's Annual Report.</p> <p>It's important to note that this paragraph should not be applicable to non-Indian companies, as they may not be subject to mandatory audit requirements.</p> <p>Valuers have the discretion to indicate whether they have received the audited statements of the Portfolio Company or not. In addition to this, the Manager may be required to disclose the names of the companies from which they have obtained the audited financials before the completion of the AIF audit. This information should be shared with all the investors in the AIF, as opposed to the conditions outlined in Paragraph 9.1</p>
9.2	<p>Manager of AIF shall ensure that valuation based on audited data of investee company is reported to performance benchmarking agencies only after the audit of books of accounts of the AIF in terms of Regulation 20(14) of AIF Regulations, within the stipulated timelines.</p>	<p>The audit due date is September 30, as per Company's Act 2013. To ensure that the AIF can send audited financials to the Benchmarking Agency, a further month is requested for the same</p>	<p>Allow the AIFs 7 months from the end of March 31 to provide info to the Benchmarking Agencies in case audited financials are needed.</p>
10	<p>The manager of AIF shall submit report on compliance with the provisions of this circular on SEBI Intermediary Portal (www.siportal.sebi.gov.in) in the format as specified therein.</p>	<p>Some of the AIFs tried searching for the report format but could not find it on the portal.</p>	<p>This feature on the portal needs to be activated.</p>
12	<p>Circular being effective from Nov 1st 2023</p>	<p>By 1/11/2023, almost all the AIFs would have completed their audit and valuation for FY 23</p>	<p>Make the circular effective for valuation as of March 2024 onwards</p>