

Regulatory Paradigm Shift for Blended Finance in GIFT-IFSC

Introduction

On October 22, 2025 the International Financial Services Centres Authority (**IFSCA**) published a consultation paper (**Consultation Paper**) proposing that Venture Capital Schemes, Restricted Schemes, and eligible Environmental, Social or Governance Schemes (**ESG Schemes**) established in the Gujarat International Finance Tech-City International Financial Services Centre (**GIFT-IFSC**) and regulated by the IFSCA (Fund Management) Regulations, 2025 (**FM Regulations**) be permitted to allow “differential distribution” of returns among investors in order to enable blended finance and flexible fund structures.

Blended finance operates on the premise that different investor groups may have different risk-return objectives. Concessional participants, often multilateral agencies, development finance institutions, or philanthropic investors may intentionally accept subordinated or reduced returns to crowd in commercial capital. The Consultation Paper recognises that achieving such structuring in pooled fund vehicles requires the flexibility to issue multiple classes of units with differentiated distribution entitlements. Below is a summary of the key proposals mentioned in the Consultation Paper.

Key Proposals

- **Differential Distribution in AIFs:** IFSCA proposes to allow Venture Capital Schemes and Restricted Schemes in IFSC to issue multiple classes of units with different distribution (waterfall) rights such as:
 - “Senior units” which have superior rights over the distribution proceeds; and
 - “Junior/Subordinate” including “Mezzanine” units which rights inferior to such Senior units. Holders of Junior units may bear higher losses/ get lower returns than what they would be ordinarily entitled to in any one or the combination of the following forms:
 - accept lower financial return than their pro-rata share;
 - agreeing to bear higher portfolio losses than their pro-rata shares;
 - accept zero financial return from their investments; and/or
 - getting units in return of investments in eligible ESG Schemes by way of grants.
- **Disclosure and Safeguards:** The Consultation Paper emphasizes the need for heightened disclosure requirements in the Private Placement Memorandum (**PPM**) such as details of the different class of units, their rights in distributions, and highlighted additional risks including detailed illustrations of distribution waterfalls under multiple scenarios, particularly those involving capital impairment for subordinated classes, and clearly articulated associated risks.
- **Independent valuers:** The Consultation Paper also calls for the appointment of independent valuers for calculation of Net Asset Value (**NAV**) per unit class after taking into account the disclosures in the PPM and the documented process for calculating NAV, and mandates transparent use of grants, especially in ESG-linked schemes.
- **Minimum Investment Thresholds and Accredited Investors:** To protect vulnerable participants, a higher minimum subscription threshold of USD 2 Million has been proposed for junior/subordinate tranches, and USD 1 million for accredited investors.
- **Restrictions Against Evergreening:** The framework proposed by the Consultation Paper specifically addresses regulatory concerns about the possible misuse of subordinated tranches to evergreen stressed assets by mandating FMEs to ensure that schemes do not permit investee companies to use the amounts invested in them by such schemes to discharge their obligations to investors of the schemes or to their associates.

- **Other Restrictions:** Investments of an Eligible Scheme, other than ESG-Schemes, in an investee company or its associates, will be subject to the cap of 25% (twenty-five percent) of the corpus. The proposal however provides for a grace period of 2 (two) years from the date of first closing to these schemes to achieve the required portfolio diversification.
- **Grant Funding for ESG Schemes:** ESG schemes may accept up to 20% (twenty per cent) of their corpus in the form of grants, as an additional tool for catalytic funding of socially impactful ventures, subject to specific investment and utilization norms. Further, the proposal mandates Fund Management Entities (**FMEs**) to disclose how the investments by the scheme are expected to align with the United Nations Sustainable Development Goals (**SDGs**).

ELP Comments

IFSCA's proposal to facilitate blended finance through carefully regulated differential distribution tranching embraces structural flexibility and marks a notable shift and positions GIFT-IFSC as a hub for catalytic capital and sophisticated fund structuring.

That said, while the Consultation Paper opens the door to multi-tranche fund structures, it simultaneously places the blended unit classes in a straightjacket by requiring that the rights and obligations attached to the junior classes be restricted to the four options stated in Paragraph 4.6 of the draft circular. For example, schemes cannot issue units which could have rights and obligations similar to equity and preference shares, where one class of units can have priority in receiving returns, while the other class may take the balance returns once the first class of units are paid their promised returns. This approach significantly limits the structuring flexibility of schemes. A fully laissez faire approach, subject).

IFSCA's approach is in contrast to the approach taken by the Securities Exchange Board of India (**SEBI**) with respect to pro-rata, pari passu rights and priority distribution models. Below is a table highlighting the differences in approach of both the regulators:

Aspect	IFSCA (GIFT-IFSC) [proposed]	SEBI (Domestic AIFs)
Differential Distribution (PD Model)	Permitted with strict safeguards, disclosure, and high entry thresholds for junior tranches.	Explicitly banned in 2022- No fresh commitments or investments by AIF schemes following PD models permitted.
Pari Passu / Pro Rata Rights	Default principle is pro rata; but exceptions created for blended finance and impact-oriented structures.	Investors in an AIF must hold rights on a pro-rata and pari passu basis to their commitments with very limited exceptions, such as the issue of Carry Units to investment managers and sponsors.
Objective	Focus on catalyzing developmental projects, attracting international concessional capital, and aligning to global norms	Addressing issues of evergreening of loans by regulated entities, ensuring investor protection, equitable treatment, and avoidance of regulatory arbitrage.

These parallel frameworks reflect the broader policy diversity in India's financial ecosystem and highlight the importance of contextual and risk-sensitive regulation: SEBI prioritizes uniform investor treatment and systemic risk safeguards, whereas IFSCA appears to have adopted a laissez faire approach which is also more in line with global practices than SEBI's approach. It is important to note that neither approach is inherently superior; rather, each approach is tailored to its market's characteristics, development stage, and strategic objectives, underlining the

dynamic regulatory landscape local and international investors must now navigate. The success of IFSCA's proposed framework will ultimately depend on robust implementation the proposed safeguards.

The Consultation paper on 'Regulatory Framework for differential distribution in Restricted Schemes and Venture Capital Schemes to facilitate blended finance and other fund structures' can be found [here](#).

We hope you have found this information useful. For any queries/clarifications please write to us at insights@elp-in.com or write to our authors:

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