

SEBI proposes new rules for the maintenance of pro-rata rights of investors of AIFs

On November 7, 2025, the Securities and Exchange Board of India (**SEBI**) circulated for public comments a draft circular offering clarifications on various words and terms mentioned in Regulation 20(21) of AIF Regulations (**Proposals**). Regulation 20(21) and Regulation 20(22) were inserted in the AIF Regulations last November through an amendment to the SEBI (Alternative Investment Funds) Regulations, 2012 (**AIF Regulations**). The aforementioned amendments were notified on November 18, 2024 and these provide for maintaining pro-rata and pari-passu rights of investors in a scheme of an AIF. Subsequent to the amendments, SEBI issued a circular dated December 13, 2024 on 'Pro-rata and *pari passu* rights of investors of AIFs'. Part A of the aforementioned circular prescribed, inter-alia, specific exemptions with respect to maintaining pro-rata rights of investors of AIFs.

Regulation 20(21) of AIF Regulations reads as follows:

"The investors of a scheme of an Alternative Investment Fund shall have rights, pro-rata to their commitment to the scheme, in each investment of the scheme and in the distribution of proceeds of such investment, except as may be specified by the Board from time to time:

Provided that the rights of the investors of a scheme of Alternative Investment Fund issued prior to the notification of the Securities and Exchange Board of India (Alternative Investment Funds) (Fifth Amendment) Regulations, 2024, which are not pro-rata to their commitment to the scheme and not exempted by the Board, shall be dealt with in the manner specified by the Board."

Interpretation of the words "commitment to the scheme"

- The words "commitment to the scheme" appear twice in Regulation 20(21) of the AIF Regulations. The Proposals clarify that:
 - *For the purpose of drawing down capital from investors of a scheme of an AIF on a pro-rata basis for making investments and for distribution of proceeds from such investments, the words "commitment to the scheme" in Regulation 20(21) of AIF Regulations shall be construed as either "commitment" or "undrawn commitment".*
 - *The investors of a scheme of an AIF shall have rights in distribution of proceeds of an investment which can be either:*
 - *pro-rata to their contribution to such investment; or*
 - *pro-rata to their contribution to such investment on a time weighted pro-rata basis, as clearly disclosed upfront to investors in the PPM of the scheme.*
 - *'Undrawn commitment' shall mean the commitment made by the investor to the scheme, net of funds already drawn down by the AIF for making investments or otherwise.*
- The proposals mandate that commitments should be recorded/recognised in INR (and not in any foreign currency) in the contribution agreement for the purpose of calculation of the corpus of the scheme. This commitment amount stated in INR shall form the basis for deciding the drawdown amount on the basis of pro-rata to commitment or undrawn commitment of the investor. This rule applies for non-residents too.

Upfront disclosure of drawdown methodology

- The basis for calculating pro-rata rights, whether based on commitment or undrawn commitment of the investor(s), should be disclosed upfront in the PPM of the scheme and cannot be changed during its tenure.
- If a scheme of an AIF opts for drawdown methodology based on commitment of investors to the scheme and if an investor does not participate in a particular investment due to excuse/exclusion, the unutilised commitment

of the investor to this extent, shall not be used for making subsequent investments. The aforementioned condition should also be disclosed upfront to the investors of the scheme, via the PPM.

- The drawdown methodology adopted by the scheme of an AIF should not result in any investor holding a disproportionate stake in an investee company through the AIF. The ratio of investor's contribution to an investee company vis-à-vis investor's commitment to the scheme shall not exceed the concentration limit prescribed for the scheme under Regulation 15(c) of the AIF Regulations. Regulation 15(c) of the AIF Regulations states that a Category I or Category II AIF's stake in an investee company shall not exceed 25% of its investable funds, unless it is a large value fund for accredited investors of Category I and II, in which case the concentration threshold shall be 50% of its investable funds.

Differential treatment of open-ended and close-ended schemes

- Investors in open ended schemes of Category III AIFs may invest in the scheme any amount, at any time, at their discretion, subject to compliance with clause 4.7 of SEBI Master Circular for AIFs dated May 07, 2024 which requires that the first lumpsum payment made by the investors should not be less than the minimum investment amount. For investors in open ended schemes of Category III, drawdown on pro-rata basis is not required under the Proposals. Instead, open ended schemes of Category III AIFs, shall issue and redeem units at NAV, and other proceeds, if any, shall be distributed pro-rata to units held by the investors.
- If an open-ended scheme of Category III AIF has invested or is proposing to invest primarily in unlisted securities, then the conditions specified at para 4 above shall be complied with.
- In case, a close ended scheme of an AIF issues and redeems units at NAV, such scheme shall also satisfy the conditions given in **Error! Reference source not found.**(**Error! Reference source not found.**) and **Error! Reference source not found.**), above while drawing down capital for making investment.

Alignment of drawdown methodology for existing AIF schemes with the Proposals

- Existing schemes of AIFs which are not following the methodology prescribed by the Proposals for drawing down or accepting money from their investors for making investments are required to align their drawdown methodology with the methodologies set out in the Proposals. No existing scheme may issue a drawdown notice after the Proposals are made effective unless they have aligned their drawdown methodology with the methodologies set out in the Proposals.
- The amendment of the PPM of an existing scheme to align the drawdown methodology with one of the methodologies prescribed by the Proposals does not require any investor consent and shall not be construed as a 'Material Change'. However, such alignment shall be disclosed explicitly to the investors. The investors in such schemes shall have the option to continue or not continue contributing to investments made by the AIF post the issuance of this circular. In case they opt not to, they will not be considered to have violated any provision of the AIF Regulations or of the PPM.

Distribution of proceeds from investments made on or before December 13, 2024 by AIF schemes with non-compliant priority distribution models

- Para 9 of SEBI's circular dated December 13, 2024 had directed that then existing schemes of AIFs that had adopted priority distribution models which were not covered by the exemption provided by paragraph 5 of the said circular should neither accept any fresh commitment nor invest in a new investee company, directly or indirectly.
- The Proposals provide that AIFs may distribute the proceeds from investments already made by them on or before December 13, 2024 as per the terms of distribution/distribution waterfall as disclosed in PPM and/or other fund documents.

Extension of exemption from obligation to maintain pro-rights extended to employees/directors/partners of the AIF's manager

On December 13, 2024, SEBI had issued a circular regarding the pro-rata and pari-passu rights of investors of AIFs which had provided an exemption to investment managers and sponsors of AIFs from the requirement of maintaining pro-rata

rights of investors in distribution of proceeds of investments of a scheme. The Proposals extent this exemption to the employees/directors/partners of the AIF's manager.

Implementation standards awaited

The Proposals state that the Standard Setting Forum for AIFs (**SFA**), in consultation with SEBI, shall formulate implementation standards for compliance with the Proposals. The implementation standards formulated by SFA, if any, shall be published on the websites of the industry associations which are part of SFA, i.e., Indian Venture and Alternate Capital Association ([IVCA](#)), [PEVC CFO Association](#) and the Trustees Association of India ([TAI](#)).

ELP Comments

- From a fund accounting point of view, when drawing down capital from investors in an AIF scheme, there is a world of difference if such drawdown is on the basis of an investor's full "commitment" to such AIF or it is based on investors "undrawn commitment" in such AIF. This is primarily because different classes of investors have different management fees and the holders of units of classes with lower management fees will, over the course of the AIF's commitment period, have a higher percentage of undrawn commitment than the holders of units of classes with higher management fees. Let's analyse this rule with a hypothetical case:

A Category III AIF (Alpha Fund) has two classes of units i.e. Class A and Class B with the following management fee structure and investment commitment threshold:

Class of Units	Commitments threshold	Management Fees
Class A	Minimum INR 1 crore but not more than INR 5 crore	2% of Capital commitment
Class B	Above INR 5 crore	1% of Capital commitment

Mr. X and Mr. Y are investors in Alpha Fund and have committed ₹2 and ₹7 crore respectively in Alpha Fund. The following tables show the differences that crop up when drawdown is based on total commitment vis-à-vis undrawn commitment.

Mr. X:

Year	Capital drawdown towards Management Fee (Based on total commitment)	20% drawdown towards Investments based on Total Committed Capital (Methodology A)	20% drawdown towards Investments based on Undrawn Capital (Methodology B)	Undrawn Capital (Method A)	Undrawn Capital (Method B)
Year 1	2,00,000	40,00,000	39,60,000	1,58,00,000	1,58,40,000
Year 2	2,00,000	40,00,000	31,68,000	1,16,00,000	1,24,72,000
Year 3	2,00,000	40,00,000	24,94,400	74,00,000	99,77,600

Mr. Y:

Year	Capital drawdown towards Management Fee (Based on total commitment)	20% drawdown towards Investments based on Total Committed Capital (Methodology A)	20% drawdown towards Investments based on Undrawn Capital (Methodology B)	Undrawn Capital (Method A)	Undrawn Capital (Method B)
Year 1	7,00,000	1,40,00,000	1,38,60,000	5,58,00,000	5,54,40,000
Year 2	7,00,000	1,40,00,000	1,09,48,000	4,11,00,000	4,37,92,000
Year 3	7,00,000	1,40,00,000	86,18,400	2,64,00,000	3,44,73,600

From the example above, it can be understood that drawdowns based on total commitment and drawdowns based on undrawn commitment affect investors differently, based on their management fees and other fees such as operating expenses. Also, it is likely that some classes will exhaust their capital commitment faster than others and in such a scenario, a drawdown pro rata to undrawn capital commitment can enable a fund to drawdown capital from investors such as Mr. Y, even if Mr. X may have already exhausted his capital commitment.

- On April 10, 2023, vide circular bearing number SEBI/HO/AFD-1/PoD/P/CIR/2023/053, SEBI permitted AIFs to excuse their investors from participating in any particular investment in certain specific circumstances. The impact of this freedom given to AIFs is that towards the end of an AIF's lifecycle, an investor excluded from one or more previous investments will have a higher percentage of undrawn capital commitment than other investors in the same AIF. In this context, the Proposals state that if an AIF scheme's drawdown methodology is based on total commitment and if an investor in such AIF does not participate in a particular investment due to excuse/exclusion, the unutilised commitment of the investor to this extent, shall not be used for making subsequent investments. So, if an AIF issues a drawdown notice for 20% of each investor's total capital commitment in order to invest in Delta Private Limited and one investor is excluded from investing in Delta Private Limited, that investor's capital commitment has to be reduced by 20% and cannot be drawdown subsequently. However, if the AIF's drawdown methodology is based on undrawn commitment, this rule will not apply and even if one investor is excluded from investing in Delta Private Limited, such investor's capital commitment does not have to be reduced at all and can be drawdown subsequently.
- Paragraph 4.6 of the Proposals state as follows:

Drawdown methodology should not result in any investor holding disproportionate stake in an investee company through the AIF, i.e., the ratio of investor's contribution to an investee company vis-à-vis investor's commitment to the scheme shall not exceed the concentration limit prescribed for the scheme under Regulation 15(c) of AIF Regulations.

We feel that the language of Paragraph 4.6 of the Proposals is not clear enough, but let's use an example to understand this rule better. An AIF has twenty investors, nineteen of whom are in Class A and have invested 1 crore each and one investor is in class B and has invested 11 crores. The total corpus of the AIF is 30 crores. Towards the end of the AIF's commitment period, the investor in class B has undrawn commitment of 50% of his total commitment, which amounts to Rs. 15 crore. The AIF wishes to invest Rs. 6.32 crores in Penta. The investors in class A have undrawn commitment of 10% each, which amount to Rs. 10 lakh per Class A unitholder. The AIF uses the "undrawn commitment" methodology and issues a drawdown notice for 80% of each investors' undrawn commitment. This would cause the nineteen investors in class A to invest Rs. 1.52 crores each in Penta and the investor in class B to invest Rs. 4.8 crores in Penta. If the AIF issues a drawdown notice as mentioned above, based

on the methodology of “undrawn commitment”, the investor in class B may be in breach of the rule proposed by Paragraph 4.6 above.

Interestingly, the aforementioned Paragraph 4.6 of the Proposals does not refer to Regulation 15(d) of AIF Regulations, which prescribes the concentration limit for Category III AIFs (which is not more than ten per cent of the investable funds and twenty per cent of the investable funds for large value funds). Thus, the rule in Paragraph 4.6 of the Proposals seems to be meant to apply only to Category I AIFs and Category II AIFs and not to Category III AIFs.

- The Proposals state that pro-rata rights with respect to distribution of proceeds of an investment can be either pro-rata to their contribution to such investment, or pro-rata to their contribution to such investment on a time weighted pro-rata basis, and this must be clearly disclosed upfront to investors in the PPM of the scheme. It is understandable that calculation of pro rata rights for distribution of exit proceeds cannot be on the basis of capital commitment (since committed capital may not be fully drawn down) or undrawn capital commitment. It is interesting to note that SEBI intends pro-rata rights to be based on each investor’s contribution to the relevant investment and not on the basis of the investor’s aggregate investment in the Fund, which would have aligned with the principle of all investors sharing the risks and rewards of all the investments made by the AIF. However, this new rule proposed by SEBI will ensure that any investor who was excluded from an investment does not participate in the profits or losses flowing from such investment.
- Administrators and accountants who manage the accounts of AIFs always had to travel beyond the black letter law contained in the AIF Regulations since the AIF Regulations do not provide the fine print to cover every possible scenario that arises in the course of computation of drawdown amounts and investor shares when exit proceeds are to be distributed. The clarifications offered by the Proposals do reduce the freedom which fund administrators and fund accountants had in this regard till now, but it is likely that further clarifications will be needed to settle the various questions that are being constantly thrown up on account of the insertion of Regulation 20(21) in the AIF Regulations and SEBI’s circular of December 13, 2024 which granted a few specific exemptions with respect to maintaining pro-rata rights of investors of AIFs. The implementation standards that may be issued by the SFA for compliance with the Proposals will double address some of those questions, but the final word on pro-rata rights and the exemptions for the same, is a long way off.

SEBI’s circular dated November 7, 2025 containing the Proposals can be found [here](#)

SEBI’s circular dated December 13, 2024 on ‘Pro-rata and pari passu rights of investors of AIFs’ 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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