# Sebi may bring valuation norms for AIFs

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The Securities and Exchange Board of India (Sebi) may prescribe standard valuation norms for alternative investment funds (AIFs) along the lines of International Private Equity and Venture Capital Valuation (IPEV) Guidelines, which are followed by funds globally.

The regulator may also prescribe a list of valuers, which may include global consultancy firms and independent valuers, said people in the know.

The aim is to set out best practices for determining fair value of AIF investments, especially in unlisted startups, real estate, infrastructure and the credit space. The guidelines are expected to provide a framework that is consistent with global accounting principles and make the Rs 6.94-trillion AIF industry more competitive.

Existing rules require an AIF to provide a valuation report to investors once every six months or every year. The funds are free to use their own methodology and choose any valuer. Large funds and those with sizeable foreign investments, however, already follow IPEV guidelines, according to industry officials.

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"At present, you could have a situation where the same unlisted investment has wildly differing fair market values across different funds depending on who does the valuation and the methodology used. Distortions in valuations could especially be glaring for investments in startup firms. A standard set of valuation norms will help investors better track the progress of their investment during the life of the fund and know its value if the fund were to be liquidated on a particular date," Siddarth Pai, partner, 3one4 Capital, said.

Unlike mutual funds where the net asset values reflect the price daily, AIFs typically value their portfolio companies yearly or half-yearly. The current valuation requirement creates a number of hurdles for fund managers especially in case of unlisted companies, including startups. In such cases, the fund manager may need to rely on data that is provided by the portfolio companies, which may not be readily available. Typically, a fund manager may simply rely on valuation followed in the last round of investment into the portfolio company.

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“Can you really do that? There are no guidelines on this at the moment,” an industry official said. “A fund manager wanting to play mischief can artificially inflate the valuation and say something worth Rs 10 is worth Rs 80. And so on a mark-to-market basis he can say he is super outperforming and the fund is on track to make you 2x, 3x, 4x returns over the next 8-10 years.”

In developed markets, AIFs have come under the regulatory radar after the 2008 financial crisis.

“If you go by history, most of the financial losses are incurred due to mispricing of assets. Investor interest in the unlisted space has waned of late due to frothy valuations and value erosion of the privately funded companies after listing. Fair valuation and timely disclosure will help funds holding such companies as part of their portfolio depict a more accurate performance picture to its investors,” said Deviprasad Nair, head of business at Helios Capital India.

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An email sent to Sebi did not immediately get a response.

According to Parul Jain, head of fund formation, Nishith Desai Associates, funds invest in a large number of companies over their life, and separate valuation norms may push up the cost of running an AIF, which may ultimately have to be passed on to the investors.

“Given the illiquid nature of private investments, the regulator may consider adopting a rule permitting fund managers to ascertain the value of investments in good faith, including determining the need for an external valuer. This may be in line with norms followed in some countries, and the fund manager may periodically assess and manage risks associated with such fair valuations,” Jain said.

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