



CIRCULAR

SEBI/HO/AFD/PoD/CIR/2023/15

January 12, 2023

To,

**All Alternative Investment Funds (AIFs)
All Custodians**

Sir/Madam,

Sub: Participation of AIFs in Credit Default Swaps

1. SEBI (Alternative Investment Funds) Regulations, 2012 ('AIF Regulations'), have been amended and notified on January 09, 2023 to allow AIFs to participate in Credit Default Swaps ('CDS') as protection buyers and sellers. Copy of the notification is available at [link](#).
2. Regulations 16(1)(aa), 17(da), 18(ab) and 20(11) of AIF Regulations enable AIFs to participate in CDS in terms of the conditions as may be specified by SEBI from time to time. In this regard, the following is specified:

A. Conditions applicable to Category I, II and III AIFs for buying CDS:

- 2.1. Category I AIFs and Category II AIFs may buy CDS on underlying investment in debt securities, only for the purpose of hedging.
- 2.2. Category III AIFs may buy CDS for the purpose of hedging or otherwise, within permissible leverage as specified in SEBI circular no. CIR/IMD/DF/10/2013 dated July 29, 2013.

B. Conditions applicable to Category II and III AIFs for selling CDS:

- 2.3. Category III AIFs may sell CDS, subject to the condition that effective leverage undertaken is within the permissible limits as specified in SEBI circular no. CIR/IMD/DF/10/2013 dated July 29, 2013.
- 2.4. Further, Category II AIFs and Category III AIFs may sell CDS, by earmarking unencumbered Government bonds/Treasury bills equal to the amount of the said CDS exposure. Such earmarked securities may also be used for maintaining applicable margin requirements for the said CDS exposure. Exposure to CDS undertaken in the aforesaid manner shall not tantamount to leverage.



- 2.5. Total exposure to an investee company, including exposure through CDS, shall be within the limit of applicable concentration norm as specified in AIF Regulations.

C. Other conditions applicable for transacting in CDS:

- 2.6. AIFs shall report details of CDS transaction to the custodian, by the next working day, in the manner as specified by the custodian.
- 2.7. Custodian, shall put in place a mechanism to collect necessary details from AIFs transacting in CDS, to monitor the compliance with conditions specified at para 2A and para 2B above.
- 2.8. The obligation of manager/AIF and custodian in case of breach of leverage limits due to transactions in CDS by Category III AIFs, shall be as specified in para 3.4 of SEBI circular no. CIR/IMD/DF/10/2013 dated July 29, 2013 read with para 1 of SEBI circular no. CIR/IMD/DF/14/2014 dated June 19, 2014.
- 2.9. Further, for Category II AIFs and Category III AIFs which sell CDS by earmarking securities in the manner as mentioned at para 2.4 above, in case the amount of earmarked securities falls below CDS exposure:
- a. The AIF shall send a report to custodian on the same day of the breach.
 - b. The AIF shall bring the amount of earmarked securities equal to CDS exposure and report details regarding rectification of breach to custodian, by the end of next trading day.
 - c. In case the AIF fails to rectify the breach in the manner as specified above, the custodian shall report details of the breach to SEBI, on the next working day.
- 2.10. Any unhedged position, which shall result in gross unhedged positions across all CDS transactions exceeding twenty-five percent of investable funds of the scheme of an AIF, shall be taken only after intimating to all unit holders of the scheme.
- 2.11. In terms of Regulations 16(1)(c) and 17(c) of the AIF Regulations, Category I and II AIFs shall not borrow funds directly or indirectly and engage in leverage except for meeting temporary funding requirements for not more than thirty days, not more than four occasions in a year and not more than ten percent of the investable funds. In this regard, Category I and Category II AIFs which transact in CDS, shall maintain thirty days cooling off period between the two periods of borrowing or engaging in leverage.



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- 2.12. All CDS transactions shall be on a platform regulated by SEBI or Reserve Bank of India ('RBI'), to enhance transparency and disclosure.
- 2.13. AIFs transacting in CDS, shall also ensure compliance with applicable provisions of RBI notification on 'Master Direction – Reserve Bank of India (Credit Derivatives) Directions, 2022', dated February 10, 2022 and other directives issued by RBI in this regard from time to time.
3. This circular shall come into force with immediate effect.
4. This circular is issued with the approval of the competent authority.
5. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.
6. The circular is available on SEBI website at www.sebi.gov.in under the categories "Legal framework -Circulars" and "Info for -- Alternative Investment Funds".

Yours faithfully,

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