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**RECALIBRATING BLENDED FINANCE: THE INDIAN REGULATORY  
FRAMEWORK AND THE IFSCA SHIFT**

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ABSTRACT

*Blended finance has emerged as a critical mechanism for mobilising private capital towards development-oriented and high-risk sectors, particularly in emerging economies such as India. By combining concessional capital with commercial investment, it seeks to address structural market failures, including information asymmetry, lack of credit access, and the underfunding of socially significant sectors such as MSMEs, climate infrastructure, and women-led enterprises. Despite its growing relevance, the Indian regulatory framework governing blended finance remains fragmented, with no single comprehensive legal regime addressing its structure and implementation.*

*This paper examines the legal and regulatory landscape applicable to blended finance in India, highlighting the role of multiple frameworks, including the RBI directions and SEBI (Alternative Investment Funds) Regulations, 2012. It focuses particularly on two key regulatory mechanisms — RBI's co-lending and default loss guarantee framework, and the AIF regime — which operationalise risk-sharing and capital pooling but also impose structural limitations on differentiated risk allocation.*

*The paper further analyses recent developments introduced by the International Financial Services Centres Authority (IFSCA), which proposes permitting differential distribution rights within fund structures to better accommodate blended finance models. While this marks a significant shift towards greater flexibility, it also raises questions regarding regulatory consistency and safeguards against misuse.*

*The paper concludes that although India is moving towards enabling blended finance, achieving an optimal balance between flexibility and regulatory oversight remains essential for scaling such structures effectively.*

**Key Words:** Blended Finance, Alternative Investment Fund, IFSCA.

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### I. INTRODUCTION

The World Economic Forum and the Organisation for Economic Co-operation and Development (OECD) define blended finance as “the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets.”<sup>1</sup> Blended concessional finance, or blended finance, combines concessional finance from donors or third parties alongside development finance institutions’ (DFIs’) normal own account finance and/or commercial finance from other investors.<sup>2</sup> The objective is to develop private sector markets, advance the Sustainable Development Goals (SDGs), and mobilize additional private resources.<sup>3</sup>

The usual business model of DFIs is to provide finance at commercial rates in higher risk environments to achieve development outcomes that the private sector alone may not be able to achieve.<sup>4</sup> However, certain projects with persistent market failures, high risks and new technologies and novel business models make such projects unviable even for DFIs. Blended finance has emerged as one of the several tools developed by the international development community to mitigate these risks and catalyse investment into such impactful projects.<sup>5</sup>

The need for this mechanism is particularly acute in developing regions. For instance, developing Asia needs US\$1.7 trillion annually in infrastructure investments until 2030 to sustain growth while addressing climate change challenges. Blended finance can help unlock the flow of capital to such projects.<sup>6</sup>

According to Convergence, a global network for blended finance, approximately USD 262 billion has been mobilised in developing countries through blended finance.<sup>7</sup> Between 2020 and 2024, annual mobilisation increased steadily from USD 11.5 billion to USD 18.3 billion, reflecting consistent growth. On average, every dollar of concessional capital, including guarantees and

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<sup>1</sup> World Econ. Forum & Org. for Econ. Co-operation & Dev., *Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders* (Sept. 2015).

<sup>2</sup> *Id.*

<sup>3</sup> Int’l Fin. Corp., *The Role of Blended Finance in an Evolving Global Context* (Nov. 25, 2025), <https://www.ifc.org/content/dam/ifc/doc/2025/role-of-blended-finance-in-an-evolving-global-context.pdf> (last visited Apr. 5, 2026).

<sup>4</sup> Emelly Mutambatsere & Philip Schellekens, *The Why and How of Blended Finance: Recommendations to Strengthen the Rationale for and Efficient Use of Concessional Resources in Development Finance Institutions’ Operations* (World Bank, Nov. 2020).

<sup>5</sup> Int’l Fin. Corp., *The Role of Blended Finance in an Evolving Global Context* (Nov. 25, 2025), <https://www.ifc.org/content/dam/ifc/doc/2025/role-of-blended-finance-in-an-evolving-global-context.pdf> (last visited Apr. 5, 2026).

<sup>6</sup> Int’l Fin. Corp., *Pentagreen Capital to Manage EAST-P’s Green Investments Partnership, Seeking to Deploy US\$1 Billion for Asia’s Sustainable Infrastructure*, IFC Press Room (Nov. 12, 2024), <https://www.ifc.org/en/pressroom/2024/pentagreen-capital-to-manage-fast-p-s-green-investments-partnership-seeking-to-deploy-us-1-billion-for-asia-s-sustainable-infrastructure> (last visited Apr. 5, 2026).

<sup>7</sup> Convergence Blended Fin., *State of Blended Finance*, <https://www.convergence.finance/state-of-blended-finance> (last visited Apr. 6, 2026).

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insurance, mobilised USD 3.76 in commercial capital from DFIs, Multilateral Development Banks (MDBs), and the private sector.<sup>8</sup>

The blended finance market in India is nascent but appears to be approaching an inflexion point.<sup>9</sup> The regulatory environment governing finance has been evolving through structural reforms and ease-of-doing-business measures to align with the demands of the changing economy. Given the importance of blended finance in the current times and particularly for developing countries, it is important to analyse the legal framework for blended finance in a country like India.

In this article, Part II discusses the need for blended finance in India. Part III will present the Indian position on blended finance structures and will examine the key legal and regulatory framework applicable laws in this regard. Part IV discusses two important regulatory mechanisms that are particularly relevant to blended finance. Part V analyses the recent consultation paper issued by the International Financial Services Centres Authority (IFSCA), which proposes greater flexibility for Alternative Investment Fund (AIF) structures within the IFSC to facilitate blended finance. Finally, the article compares the proposed framework with the existing domestic Indian legal position and suggests key analytical takeaways.

## II. THE STRUCTURAL NEED FOR BLENDED FINANCE IN INDIA

India's need for blended finance is no longer a matter of preference. It follows from the scale and composition of its financing gap. On one widely used estimate, India faces an annual SDG financing shortfall of about USD 565 billion,<sup>10</sup> which culminated in INR 533 lakh crores or USD 8.5 trillion in the next 15 years<sup>11</sup>. For climate action, the country's NDC financing requirement has been estimated at roughly INR 11 lakh crore per year, or about USD 170 billion annually<sup>12</sup>. NITI Aayog's latest Viksit Bharat and Net Zero scenario<sup>13</sup> Workplaces this challenge in an even sharper frame: India's transition will require financing structures that can absorb risk, lower the cost of capital, and mobilise private investment at scale<sup>14</sup>.

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<sup>8</sup> *Id.*

<sup>9</sup> *Int'l Fin. Corp., Blended Finance for Climate Investments in India* (Sept. 2023), <https://www.ifc.org/content/dam/ifc/doc/2023/Report-Blended-Finance-for-Climate-Investments-in-India.pdf>

<sup>10</sup> Anshul Bhamra, Harshini Shanker & Zeenat Niazi, *Achieving the Sustainable Development Goals in India: A Study of Financial Requirements and Gaps* 33 (Tech. & Action for Rural Advancement, Dev. Alternatives Grp., 2015), [https://devalt.org/images/L3\\_ProjectPdfs/AchievingSDGsinIndia\\_DA\\_21Sept.pdf](https://devalt.org/images/L3_ProjectPdfs/AchievingSDGsinIndia_DA_21Sept.pdf) (last visited Apr. 5, 2026).

<sup>11</sup> *Id.*

<sup>12</sup> ET Government, *India Needs USD 170 Billion Per Year Green Finance to Fulfill its NDCs: Climate Policy Initiative Study*, *Econ. Times* (Aug. 14, 2022), <https://government.economictimes.indiatimes.com/news/governance/india-needs-usd-170-billion-per-year-green-finance-to-fulfill-its-ndcs-climate-policy-initiative-study/93532294> (last visited Apr. 5, 2026).

<sup>13</sup> NITI Aayog, *A Study Report on Scenarios Towards Viksit Bharat and Net Zero: An Overview* vol. 1 (2026), <https://niti.gov.in/sites/default/files/2026-02/Scenarios-Towards-Viksit-Bharat-and-Net-Zero-%20An-Overview-Vol1.pdf> (last visited Apr. 5, 2026).

<sup>14</sup> *Id.*

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The deeper point is that India's existing financing channels are not designed for this task. Public budgets remain indispensable, but they cannot on their own meet the size of the SDG and climate bill. Domestic actors already provide the overwhelming share of climate finance in India, and the Economic Survey 2025–26 notes that around 83 per cent of mitigation finance and 98 per cent of adaptation finance is sourced domestically<sup>15</sup>. At the same time, climate finance is still skewed toward mature sectors such as solar, wind, and efficiency, while adaptation, MSMEs, urban infrastructure, and hard-to-abate sectors remain underfunded<sup>16</sup>. In that sense, the issue is not merely a shortage of money, it is the absence of an instrument that can convert socially necessary but commercially fragile projects into investable propositions.

That structural mismatch is especially visible in the MSME segment. The World Bank records that MSMEs often cannot access formal credit because of a lack of collateral, low formality, and information asymmetry. RBI-aligned and IFC-linked material points to the same pattern. Enterprise finance remains constrained by the absence of reliable documentation and risk signals, which means lenders continue to price MSMEs as opaque and high-risk borrowers. This is precisely the kind of market failure that blended finance is designed to address, because concessional or catalytic capital can sit underneath commercial capital and improve the risk-return profile of the transaction.

The exclusion is sharper for women-led enterprises. IFC's India work shows that there are about 15 million women-owned MSMEs in the country, that over 70 per cent of them are in manufacturing, and that about 90 per cent of women entrepreneurs have not accessed finance from formal financial institutions<sup>17</sup>. NITI's own review of women entrepreneurship adds that 95.6 per cent of women's enterprises are unregistered or informal<sup>18</sup>. Taken together, these figures show why conventional lending channels do not merely under-serve women entrepreneurs; they often fail to see them at all. Blended finance becomes relevant here because it can support guarantee structures, first-loss layers, and other risk-sharing mechanisms that make these businesses legible to formal capital.

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<sup>15</sup> Press Info. Bureau, Ministry of Finance, *India Adopts a Development-Centred, Whole-of-Economy Climate Strategy: Integrates Adaptation, Mitigation and Behavioural Change Within Its Development Model, Says Economic Survey 2025-26*, Gov't of India (Jan. 29, 2026), <https://www.pib.gov.in/PressReleasePage.aspx?PRID=2219915&lang=1&reg=3> (last visited Apr. 5, 2026).

<sup>16</sup> *Id.*

<sup>17</sup> Int'l Fin. Corp., *Opportunities and Constraints of Women Owned Very Small Enterprises in India* (Mar. 6, 2022), <https://www.ifc.org/en/insights-reports/2022/opportunities-and-constraints-of-wvses-in-india> (last visited Apr. 5, 2026).

<sup>18</sup> Sonal Jaitly & Lakshmi Sruthi Thangallapally, *Decoding Government Support to Women Entrepreneurs in India: The Anatomy of Entrepreneurship Support Schemes* (MicroSave Consulting, under NITI Aayog Research Scheme, Oct. 2022), <https://www.niti.gov.in/sites/default/files/2023-03/Decoding-Government-Support-to-Women-Entrepreneurs-in-India.pdf> (last visited Apr. 5, 2026).

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The same logic applies to climate transition and adaptation. UNDP notes that adaptation finance in India is still primarily sourced from the national budget, while many private investors continue to treat adaptation as high-risk and low-return<sup>19</sup>. NITI Aayog's 2026 scenario work goes further and states that early-stage bets in areas such as green hydrogen, carbon capture and storage, and hydrogen-based steelmaking struggle to achieve financial closure unless credible de-risking and blended finance are brought in to reduce risk premia<sup>20</sup>. The point is not only to fund mature renewable assets, but to unlock the frontier projects and resilience infrastructure that the market will not finance unaided.

COVID-19 made this need more visible. The World Bank noted that nearly half of Indian households are vulnerable and that the majority of the workforce is informal<sup>21</sup>, while UNDP observed that the informal sector accounts for more than 85 per cent of the workforce<sup>22</sup>. In that environment, livelihood recovery, working-capital support, and last-mile economic rehabilitation require instruments that can take more risk than ordinary commercial lending. Blended finance is valuable precisely because it can support those excluded or underbanked segments without forcing all of the risk onto institutions that are otherwise governed by prudential conservatism.

Moreover, existing financing channels in India, like public expenditure, CSR allocations and conventional credit, are not merely inadequate in scale but structurally ill-suited to finance high-risk, long-gestation, and socially oriented investments. For example, public capital expenditure has increased sharply, with the government noting that it rose from ₹2 lakh crore in FY 2014–15 to ₹12.2 lakh crore in FY 2026–27 (Budget Estimate)<sup>23</sup>, but even this expansion cannot by itself crowd in the long-term capital required for infrastructure, climate, and social development. Further, these mechanisms either operate within a rigid budgetary framework that is legally constrained in their deployment or governed by risk-return expectations that preclude absorption of first-risk projects. As a result, they are incapable of performing the catalytic function necessary

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<sup>19</sup> U.N. Dev. Programme, *Building Climate Resilience in India by Initiating the National Adaptation Plan Process and Scaling Up Adaptation Finance*, UNDP Climate Change Adaptation (2024), <https://www.adaptation-undp.org/projects/building-climate-resilience-india-initiating-national-adaptation-plan-process-and-scaling> (last visited Apr. 5, 2026).

<sup>20</sup> NITI Aayog, *A Study Report on Scenarios Towards Viksit Bharat and Net Zero: An Overview* vol. 1 (2026), <https://niti.gov.in/sites/default/files/2026-02/Scenarios-Towards-Viksit-Bharat-and-Net-Zero-%20An-Overview-Vol1.pdf> (last visited Apr. 5, 2026).

<sup>21</sup> World Bank, *Concept Program Information Document (PID): Creating a Coordinated and Responsive Indian Social Protection System (CCRISP)*, Report No. PIDC31535 (Apr. 7, 2021), <https://documents1.worldbank.org/curated/en/457701617872999522/pdf/Concept-Program-Information-Document-PID-Creating-a-Coordinated-and-Responsive-Indian-Social-Protection-System-CCRISP-P176447.pdf> (last visited Apr. 5, 2026).

<sup>22</sup> Barbara Harriss-White, *India's Informal Sector: The Feeder Economy Within*, Hindu Ctr. for Pol. & Pub. Pol'y (Oct. 29, 2024), <https://www.thehinducentre.com/the-arena/current-issues/indias-informal-sector-the-feeder-economy-within/article68786567.ece> (last visited Apr. 5, 2026).

<sup>23</sup> Press Info. Bureau, *Infrastructure Financing in India: Trends, Institutions, and Innovations*, Gov't of India (Mar. 18, 2026), <https://www.pib.gov.in/PressReleaseDetail.aspx?PRID=2241612> (last visited Apr. 5, 2026).

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to crowd in private capital for development-oriented sectors. That is precisely the gap blended finance is meant to address. It does not replace public money; it uses public, concessional, or philanthropic capital to absorb risk, improve bankability, and make long-gestation projects investable for commercial capital.

At the global level, the OECD notes that private finance mobilised through official development finance interventions reached a peak of USD 70 billion in 2023.<sup>24</sup> The Indian market, while evolving, remains limited. Approximately 180 transactions between 2010 and 2022 with a cumulative value of USD 5.6 billion, and an estimated size of USD 1.1–1.3 billion in 2022, projected to reach USD 2.64 billion by 2027<sup>25</sup>. Despite this growth, it represents only a small share of global blended finance activity, underscoring its nascent nature. The OECD stresses that better data and more transparent mobilisation structures are essential because private capital does not move automatically into higher-risk developing markets. This gap equally applies to the present regulatory blind spot in India's context, where the absence of a unified and certain framework limits the effective structuring of such capital.

### III. LEGAL CHARACTERISTICS OF BLENDED FINANCE IN INDIA

Blended finance is a form of financing in which concessional finance and commercial finance are combined and subsequently invested, wherein one concessional capital category acts as a cushion for the commercial category by bearing the losses first. Now, when these different finances are being pooled and deployed under a blended finance structure, no single legislation exclusively governs the arrangement.<sup>26</sup> Instead, multiple legal frameworks become applicable depending on the source of capital, the financial instruments used, and the structure adopted.

For instance, if funds are allocated pursuant to corporate social responsibility obligations, the Companies Act, 2013, and the Companies (Corporate Social Responsibility (CSR)) Rules, 2014 govern the deployment of CSR funds for concessional financing, which may then be blended with commercial capital. Similarly, where concessional finance is routed through an AIF mechanism,

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<sup>24</sup> OECD, *Tracking Private Finance Mobilisation: Latest Trends and Ways Forward*, OECD Policy Briefs No. 25 (June 30, 2025), [https://www.oecd.org/en/publications/tracking-private-finance-mobilisation\\_8d414cdb-en/full-report/component-2.html](https://www.oecd.org/en/publications/tracking-private-finance-mobilisation_8d414cdb-en/full-report/component-2.html) (last visited Apr. 5, 2026).

<sup>25</sup> Aparna Dua, et al., *The Blended Finance India Narrative: A Decade of Blended Finance in India and What Lies Ahead* (Asha Trust & India Impact Investors Council, 2023), <https://www.convergence.finance/api/file/eb34d6582f9cb9b68d328f85204cc81a:b1706af61e7a731fb2931db1bee708a0c9544e98b3375753a83bda78ea6e15a82655d2bf89b6f2a8652016c7c4f8aab70ab3b613cd5f503b513266b3afef5312718b1e9b6ac769b95fb5f99d3a016c02f3aa0888a243ba80732b9e36961ee3ff528ccfe782130a90e233c22f356ea319d9f22d75fa4ca1c164afb77507cd76effd18b1a2fdd915db4b8d3d472f2e0af5> (last visited Apr. 5, 2026).

<sup>26</sup> Sehar Sharma & Rahul Rishi, *From Capital to Impact: Role of Blended Finance — Legal and Regulatory Framework* (Nishith Desai Assocs., June 2024), [https://www.nishithdesai.com/fileadmin/user\\_upload/pdfs/research\\_Papers/From-Capital-to-Impact-Role-of-Blended-Finance.pdf](https://www.nishithdesai.com/fileadmin/user_upload/pdfs/research_Papers/From-Capital-to-Impact-Role-of-Blended-Finance.pdf) (last visited Apr. 5, 2026).

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particularly in case of impact focused funds, the SEBI (Alternative Investment Funds) Regulations, 2012 apply.

Where the source of finance is international, such as DFIs, MDB, or foreign foundations then the applicable laws will be Foreign Contribution (Regulation) Act, 2010; particularly in relation to grants or donations that require compliance with prior approval and reporting requirements. Further, concessional debt instruments must comply with the External Commercial Borrowing Framework, in addition to the broader regulatory regime under the Foreign Exchange Management Act, 1999.

Similarly, the Income Tax Act (IT Act), 1961, becomes relevant and applicable if the income generated from blended finance activities is subjected to taxation under the act. In certain instances, the income may qualify for exemption or preferential tax treatment, depending on the nature of entities involved and provisions of the IT Act applicable on them.

It may be concluded that blended finance arrangements operate within complex legal systems, and it attracts application of multiple statutory frameworks depending on their structure and implementation.

#### **IV. KEY REGULATORY FRAMEWORKS GOVERNING BLENDED FINANCE**

While multiple statutes may apply depending on the source and nature of capital, two regulatory frameworks are particularly significant in structuring blended finance transactions in India:

- A. Reserve Bank of India (Co-Lending Arrangements) Directions; and
- B. SEBI (Alternative Investment Funds) Regulations, 2012

These frameworks are central because they directly govern mechanisms through which risk-sharing and capital pooling, the core elements of blended finance, are operationalised. The following discussion, therefore, examines these two regimes in greater detail.

##### **A. Reserve Bank of India (Co-Lending Arrangements) Directions**

The RBI (Co-Lending Arrangements) Directions, 2025—now consolidated under RBI (Commercial Banks – Transfer and Distribution of Credit Risk) Directions, 2025,<sup>27</sup> have enabled blended finance structures by encouraging cooperation between regulated lenders such as commercial banks and non-banking financial companies (NBFCs).

The directions define co-lending as an arrangement wherein a Regulated Entity (RE), along with a partner RE, jointly funds a portfolio of loans in an agreed proportion involving risk sharing. These directions primarily govern blended finance structures between regulated entities.

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<sup>27</sup> Reserve Bank of India, *Reserve Bank of India (Commercial Banks - Transfer and Distribution of Credit Risk) Directions, 2025*, Master Direction No. 159 (November 28, 2025), <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/159MD.PDF> (last visited April 05, 2026).

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Certain key features of such structuring:

1. **Default Loss Guarantee (DLG):** Direction 110 defines “default loss guarantee” as a contractual arrangement between the bank and another entity, under which the latter guarantees to compensate the bank for the losses arising from default, up to a specified percentage of the bank’s loan portfolio, as agreed upfront. Lenders are allowed to offer a default loss guarantee up to 5% of the outstanding loan amount under a co-lending or credit sourcing arrangement.
2. **Blended Rate of Interest:** Direction 107 provides that the interest rate and other fees shall be charged to the borrower on a contractual basis. The applicable rate is required to be a blended rate, calculated as the weighted average of the interest rates charged by the respective REs, proportionate to their funding share in the loan.

### B. SEBI AIF Regulations

One of the usual and prominent methods of structuring blended finance in India is through the AIF model. Under this structure, capital from sophisticated investors is being pooled and subsequently invested into identified investment avenues.<sup>28</sup>

Interestingly, in an AIF structure, the distribution of the proceeds from the investments among investors is required to be on a pro-rata and *pari-passu* basis. Regulations 20(21) and 20(22) mandate that investors within a scheme must be treated equally, and their rights must be proportionate to the amount of capital contributed.

This ultimately means that differential rights cannot ordinarily be granted to any particular class of unit holders. All the investors are required to share profits and losses in proportionate to their respective investments.<sup>29</sup> No investor may be required to bear losses beyond the extent of its capital contribution; similarly, no investor should agree to accept zero financial returns merely because of their position in the capital hierarchy.

Such a structure is in contrast to the fundamental design of blended finance, where differentiated risk arrangements between concessional and commercial capital are central to the model.

However, recognising the practical requirements of blended finance structures and the need to provide flexibility to investors, SEBI in 2024 specified a list of eligible investors who may subscribe to a junior or subordinated class of units.<sup>30</sup> These include:

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<sup>28</sup> Sec. & Exch. Bd. of India, *Frequently Asked Questions (FAQs): SEBI (Alternative Investment Funds) Regulations, 2012*, [https://www.sebi.gov.in/sebi\\_data/attachdocs/1471519155273.pdf](https://www.sebi.gov.in/sebi_data/attachdocs/1471519155273.pdf) (last visited Apr. 5, 2026).

<sup>29</sup> Vivaik Sharma, Jubin Malawat & Mudit Burad, *Pro-Rata and Pari-Passu Rights: Regulating the Differential Rights for AIF Investors*, India Corp. L. (Mar. 5, 2025), <https://corporate.cyrilamarchandblogs.com/2025/03/pro-rata-and-pari-passu-rights-regulating-the-differential-rights-for-aif-investors/> (last visited Apr. 5, 2026).

<sup>30</sup> Sec. & Exch. Bd. of India, *Pro-Rata and Pari-Passu Rights of Investors of AIFs*, Circular No. SEBI/HO/AFD/AFD-POD-1/P/CIR/2024/175 (Dec. 13, 2024), [https://www.sebi.gov.in/legal/circulars/dec-2024/pro-rata-and-pari-passu-rights-of-investors-of-aifs\\_89945.html](https://www.sebi.gov.in/legal/circulars/dec-2024/pro-rata-and-pari-passu-rights-of-investors-of-aifs_89945.html) (last visited Apr. 5, 2026).

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1. Multilateral or bilateral development financial institutions
2. State industrial development corporations
3. Entities owned or controlled by the Central Government or the state government
4. Fund manager

The present position, therefore, is that differential rights within an AIF structure are permissible only for the above categories of investors. No other class of investors is permitted to hold units with differential or subordinated rights.<sup>31</sup>

This limitation narrows the range of investors who may assume concessional or first-loss positions within an AIF scheme, thereby restricting the broader scope of blended finance arrangements. In response to this constraint and with the objective of enhancing structural flexibility, the IFSCA has issued a consultation paper proposing a framework that would allow differential rights within an AIF vehicle.

### V. IFSCA DEVELOPMENT IN DIRECTION OF BLENDED FINANCE

The Expert Committee on Sustainable Finance, set up by IFSCA, recommended the introduction of a dedicated framework to facilitate blended finance structures. On the report of this expert committee, IFSCA issued the “Consultation paper on Regulatory Framework for differential distribution in Restricted Schemes and Venture Capital Schemes to facilitate blended finance and other fund structures”.<sup>32</sup>

Under the proposals set out in the consultation paper, venture capital and restricted schemes, which are a type of AIF, would be permitted to issue “multiple classes of units with differential distribution rights.” The objective of this proposal is to facilitate AIFs that can accommodate investors with varying risk-return preferences, thereby facilitating blended finance arrangements.<sup>33</sup> The proposed framework allows one class of units to bear losses beyond their pro-rata share, to accept lower financial returns than their proportionate contribution, or even to accept zero

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<sup>31</sup> Ravi Prakash, *et al.*, *The New Architecture of Investor Fairness: SEBI's Overhaul of Pro-Rata and Pari Passu Rights in AIFs*, MONDAQ (Dec. 10, 2025), <https://www.mondaq.com/india/securities/1717294/the-new-architecture-of-investor-fairness-sebis-overhaul-of-pro-rata-and-pari-passu-rights-in-aifs> (last visited Apr. 5, 2026).

<sup>32</sup> Int'l Fin. Servs. Ctrs. Auth., *Consultation Paper on Regulatory Framework for Differential Distribution in Restricted Schemes and Venture Capital Schemes to Facilitate Blended Finance and Other Fund Structures* (Oct. 22, 2025), [https://www.ifsc.gov.in/CommonDirect/ViewFile?id=47a297ad49aae8fa365313a911a428e&fileName=Final\\_Consultation\\_Paper\\_on\\_Differential\\_Distribution\\_under\\_FM\\_Regulation\\_22102025\\_Final\\_20251022\\_0121.pdf](https://www.ifsc.gov.in/CommonDirect/ViewFile?id=47a297ad49aae8fa365313a911a428e&fileName=Final_Consultation_Paper_on_Differential_Distribution_under_FM_Regulation_22102025_Final_20251022_0121.pdf) (last visited Apr. 5, 2026).

<sup>33</sup> International Financial Services Centres Authority (Fund Management) Regulations, 2025 (amended up to July 30, 2025), [https://ifsc.gov.in/CommonDirect/PreviewPdf?id=38fea9cc5969551d78bf00e670b6d626&fileName=IFSCA\\_\\_Fund\\_Management\\_\\_Regulations\\_\\_2025\\_\\_Amended\\_up\\_to\\_July\\_30\\_\\_2025\\_\\_20251223\\_0542.pdf](https://ifsc.gov.in/CommonDirect/PreviewPdf?id=38fea9cc5969551d78bf00e670b6d626&fileName=IFSCA__Fund_Management__Regulations__2025__Amended_up_to_July_30__2025__20251223_0542.pdf) (last visited Apr. 5, 2026).

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financial returns from their investments.<sup>34</sup> Contrastingly, one class of unitholders may get a profit that is larger than their investment. This marks a significant shift from the prevailing Indian AIF regime, where distributions are required to be made on a pro-rata & *pari-passu* among investors within a scheme.<sup>35</sup>

This consultation paper has also ensured to incorporate protective measures so as to prevent misuse of the framework. For instance, a scheme is restricted from investing more than 25% of its corpus in a single investee company. Further, the investee company is prohibited from using the scheme's funds to discharge its obligation towards investors of that scheme.<sup>36</sup>

The proposed framework would enable fund management entities in IFSC to pool capital from investors with varied risk-return appetites and return expectations. In particular, junior or subordinate tranches may function as catalytic capital, absorbing higher risk to facilitate investment in socially desirable but commercially marginal projects. Such structures are designed to promote innovation in fund structuring and align the IFSC regulatory framework with global practices in blended finance.

### VI. KEY TAKEAWAY & ANALYSIS

This consultation paper represents a marked shift away from the stringent pro-rata and *pari-passu* distribution system mandated within the SEBI framework, which presently limits the scope of priority distribution structures. The proposed framework aims to facilitate a greater mobilisation of private investment, particularly for infrastructure and development projects, which require catalytic capital support.

This development assumes special importance in the light of the overall development objective of India and its net-zero commitment. Social infrastructure projects and sustainable development projects, as a rule, lack commercial viability. Frameworks like these, which can formally accommodate concessional and subordinated capital structures, may therefore enhance capital formation by improving the overall risk-return profile.

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<sup>34</sup> Vivaik Sharma et al., *Enabling Differential Distribution for Alternative Investment Funds in IFSC*, India Corp. L. (Nov. 13, 2025), <https://corporate.cyrilamarchandblogs.com/2025/11/enabling-differential-distribution-for-alternative-investment-funds-in-ifsc/> (last visited Apr. 5, 2026).

<sup>35</sup> Sec. & Exch. Bd. of India, *Pro-Rata and Pari-Passu Rights of Investors of AIFs*, Circular No. SEBI/HO/AFD/AFD-POD-1/P/CIR/2024/175 (Dec. 13, 2024), [https://www.sebi.gov.in/legal/circulars/dec-2024/pro-rata-and-pari-passu-rights-of-investors-of-aifs\\_89945.html](https://www.sebi.gov.in/legal/circulars/dec-2024/pro-rata-and-pari-passu-rights-of-investors-of-aifs_89945.html) (last visited Apr. 5, 2026).

<sup>36</sup> Int'l Fin. Servs. Ctrs. Auth., *Consultation Paper on Regulatory Framework for Differential Distribution in Restricted Schemes and Venture Capital Schemes to Facilitate Blended Finance and Other Fund Structures* (Oct. 22, 2025), [https://www.ifsc.gov.in/CommonDirect/ViewFile?id=47a297ad49aae8fa365313a911a428e&fileName=Final\\_Consultation\\_Paper\\_on\\_Differential\\_Distribution\\_under\\_FM\\_Regulation\\_22102025\\_Final\\_20251022\\_0121.pdf](https://www.ifsc.gov.in/CommonDirect/ViewFile?id=47a297ad49aae8fa365313a911a428e&fileName=Final_Consultation_Paper_on_Differential_Distribution_under_FM_Regulation_22102025_Final_20251022_0121.pdf) (last visited Apr. 5, 2026).

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At the same time, the paper also raises questions on whether flexibility along the above lines may also be considered within the SEBI framework in the country. The current AIF framework allows a subordinated class of units only for some category of investors, thereby narrowing down the scope of investors who can contribute towards the concessional capital. For instance, corporate contributors seeking to deploy CSR funds as catalytic capital are presently excluded from subscribing to subordinated units, as they do not fall within the specified list of eligible investors. This limitation constrains the potential expansion of blended finance structures in the domestic regime.

However, it is important to note that SEBI has adopted this tough stance in reaction to previous concerns<sup>37</sup> regarding the misuse<sup>38</sup> of the differential distribution mechanism, including cases of evergreening and abuse of priority rights<sup>39</sup>.

Notably, the IFSCA consultation paper attempts to address these concerns through calibrated safeguards, such as the 25% investment limit in a single investee company and the prohibition on using scheme funds to discharge investor liabilities. These measures are intended to prevent the risks that previously informed the stricter domestic position.<sup>40</sup>

Thus, the actual question, therefore, is not merely whether differential distribution rights should be permitted but whether they can be permitted in a manner that seeks to strike the right balance between flexibility and regulatory requirements. The IFSCA initiative is one such effort. It now remains to be seen whether a similar approach would be adopted within the domestic SEBI regime as the Indian blended finance landscape continues to develop.

## VII. CONCLUSION

For a country that now frames its developmental future through Viksit Bharat, blended finance is therefore not a niche market device; it is a transitional financing architecture. The OECD and World Bank both treat blended finance as a mechanism for de-risking investments that are too risky or non-commercial for ordinary market capital, using tools such as concessional loans, guarantees, subordinated capital, and equity support. In India's context, that matters because the next phase of growth will be capital-intensive, climate-constrained, and inclusion-heavy at the same

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<sup>37</sup> Pavan Burugula & Sneha Shah, *AIFs Jittery over SEBI Move to Ban Priority Distribution*, Mint (June 15, 2023), [https://www.nishithdesai.com/fileadmin/user\\_upload/pdfs/NDA%20In%20The%20Media/quotes/AIFs-jittery-over-Sebi-move-to-ban-priority-distribution-Mint.pdf](https://www.nishithdesai.com/fileadmin/user_upload/pdfs/NDA%20In%20The%20Media/quotes/AIFs-jittery-over-Sebi-move-to-ban-priority-distribution-Mint.pdf) (last visited Apr. 5, 2026).

<sup>38</sup> Sharma, *supra* note 29.

<sup>39</sup> Vivaik Sharma & Divya Laxman, *The Case for Priority Distribution Model in AIFs*, Mint (Feb. 15, 2023), <https://www.livemint.com/money/personal-finance/the-case-for-priority-distribution-model-in-aifs-11676482620141.html> (last visited Apr. 5, 2026).

<sup>40</sup> Sharma, *supra* note 34.

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time. A Viksit Bharat pathway will need more than larger budgets; it will need financial structures capable of turning developmental necessity into bankable projects.