

Alternative Investment Funds – Recent Trends, Light-Touch to Compliance Intensive

AIFs are governed under SEBI (Alternative Investment Funds) Regulations, 2012 (as amended from time to time) ('SEBI AIFs Regulations') and plays crucial role in capital market, capital formation and growth of the Indian economy, catering to sophisticated investors. AIF industry is consistently growing over the years with Compound Annual Growth Rate (CAGR) of approximately 35% p.a. in last five years^[1]. Presently, more than 1350 AIFs are registered with SEBI^[2].



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INTRODUCTION

Alternative Investment Funds (AIFs) are privately pooled investment vehicles which collect funds from Indian and/or foreign investors and invests funds in a variety of assets non-traditional or alternative assets, including real estate, infrastructure, private equity, venture capital, commodities and may employ complex long-short strategies.

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market, capital formation and growth of the Indian economy, catering to sophisticated investors. AIF industry is consistently growing over the years with Compound Annual Growth Rate (CAGR) of approximately 35% p.a. in last five years¹. Presently, more than 1350 AIFs are registered with SEBI².

AIFs form an integral part of the Private Equity (PE) and Venture Capital (VC) Industry in India.

AIFs can be registered as Trust, Company, LLP or Bodies Corporate. However, majority of the AIFs in India are registered as Trust.

AIF Industry is expected as one of the fastest growing as High-Net worth Individuals (HNIs) and ultra HNIs gets an option to generate better returns on their investments by investing in alternate/differentiated products.

In this article author have analyzed recent trends in AIFs and discussed on the shift of AIFs from light-touch to compliance intensive.

CATEGORIES OF AIFs

AIF industry is consistently evolving and growing, and comprises three categories – Category I, Category II and Category III AIFs as per SEBI AIFs Regulations. Category II AIFs have grown at a healthy pace. Majority of the AIFs are registered with SEBI are Category II AIFs.

| Category I AIF | Category II AIF | Category III AIF |
|---|--|---|
| <ul style="list-style-type: none"> Invests in start-up or early-stage ventures or social ventures or SMEs or infrastructure or other areas which are considered socially or economically desirable by the government/ regulators. It also includes the following: <ul style="list-style-type: none"> Venture Capital Funds Small And Medium Enterprises Fund Social Venture Funds Social Impact Funds Infrastructure Funds Angel Funds Special Situation Funds Such other AIFs as may be specified by SEBI | <ul style="list-style-type: none"> Funds for which no specific incentives or concessions are given by the government/ regulators. Do not undertake leverage/ borrowing other than to meet day to day operational requirements. It also includes the following: <ul style="list-style-type: none"> Private Equity Funds Debt Funds Other funds that are not classified as Category I or Category III | <ul style="list-style-type: none"> Funds that trade with a view to make short term returns, employ diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. It also includes the following: <ul style="list-style-type: none"> Hedge Funds Such other funds which are open ended and for which no specific incentives or concessions are given by the government/ regulators. |

¹ https://www.sebi.gov.in/sebi_data/meetingfiles/apr-2024/1713324885850_1.pdf

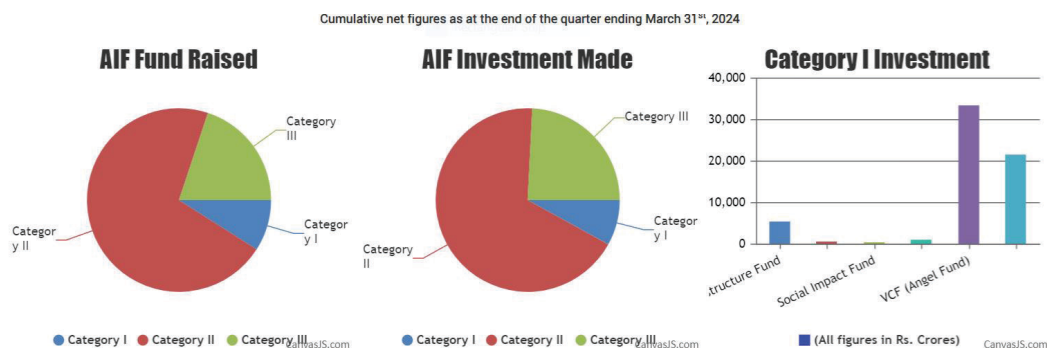
² <https://www.sebi.gov.in/sebiweb/other/OtherAction.do?doRecognisedFpi=yes&intmid=16>

- Category I and II AIFs are closed-ended funds.
- Category III AIFs can be open-ended or closed-ended funds.

RECENT TRENDS IN AIFs³

AIFs INDUSTRY'S RECORD-BREAKING INVESTMENT, COMMITMENT RAISED HAS CROSSED INR 11 TRILLION AND FUND RAISED MORE THAN INR 4 TRILLION AS ON 31 MARCH 2024 FOR THE FIRST TIME.

Data relating to activities of AIFs:



Data published by SEBI, reveals that as on 31 March 2024-

- Category I AIFs has raised approximately, INR 40,790.32 Crores
- Category II AIFs has raised approximately, INR 321,226.54 Crores
- Category III AIFs has raised approximately, INR 89,949.73 Crores

CATEGORY WISE INVESTMENT DETAILS

Below are the cumulative net figures as at the end of 31 March 2024.

| Category of AIFs | Commitments Raised | Funds Raised | Investments Made |
|---|---------------------|--------------------|--------------------|
| Category I | | | |
| Category I AIF - Infrastructure Fund | 18,849.83 | 8,466.68 | 5,449.92 |
| Category I AIF - SME Fund | 1,169.25 | 713.87 | 624.31 |
| Category I AIF - Social Impact Fund | 2,119.94 | 734.52 | 452.93 |
| Category I AIF - Special Situation Fund | 1,371.50 | 1,166.31 | 1,068.35 |
| Category I AIF - VCF (Angel Fund) | 7,053.39 | 3,829.40 | 3,343.32 |
| Category I AIF - Venture Capital Fund | 46,301.15 | 25,879.55 | 21,583.84 |
| Category I Total | 76,865.07 | 40,790.32 | 32,522.67 |
| Category II AIF | 9,12,903.00 | 3,21,226.54 | 2,76,033.37 |
| Category III AIF | 1,45,132.03 | 89,949.73 | 98,490.74 |
| Grand Total | 11,34,900.10 | 4,51,966.59 | 4,07,046.78 |

Note: The above report is compiled on the basis of quarterly / monthly information submitted to SEBI by registered Alternative Investment Funds.

GRANULAR DETAILS OF INVESTMENTS IN AIFs⁴

For the first time, SEBI has disclosed granular details of AIFs such as the funds raised from the foreign and domestic investors in AIFs, Top 10 sector wise allocation of investments, investments debt and equity wise, Investment in Start-ups and MSMEs cumulative net investment made in listed and unlisted securities.

³ <https://www.sebi.gov.in/statistics/1392982252002.html>

⁴ Granular details are clubbed for all the categories of AIFs. Granular details each category wise has been disclosed by SEBI can be accessed from the below link. <https://www.sebi.gov.in/statistics/1392982252002.html>

Top 10 Sector wise allocations:

| Sr. No | Sector | Sum of Amount Invested - for all investments including offshore. (Amt INR in 'Crores') |
|--------------------|--------------------|--|
| 1 | Real Estate | 68,540.10 |
| 2 | Others | 26,893.29 |
| 3 | IT/ITes | 24,934.55 |
| 4 | Financial Services | 21,393.66 |
| 5 | NBFCs | 19,229.53 |
| 6 | Banks | 17,769.38 |
| 7 | Pharmaceuticals | 14,004.14 |
| 8 | FMCG | 11,163.18 |
| 9 | Retail | 10,594.36 |
| 10 | Renewable energy | 10,416.80 |
| Grand Total | | 4,06,808.10 |

Real Estate sector has attracted highest investments of INR 68,540.10 Crores, followed by other sectors of INR 26,893.29 Crores and the IT/ITes sector of INR 24,934.55 Crores.

AIFs are bringing the liquidity gap in the Real Estate Sector.

Funds raised from foreign and domestic investors in AIFs:

| All Category of AIFs | Fund raised from domestic investors | FPI | FVCIs | NRIs | Others |
|--------------------------------------|-------------------------------------|------------------|-----------------|------------------|--------------------|
| Grand Total (INR in 'Crores') | 2,83,766.97 | 18,426.20 | 6,207.30 | 15,106.16 | 1,56,988.09 |

Note: Funds raised from Employee, sponsor, manager and EBTM data not included.

Investment made in listed and unlisted securities:

| All Category of AIFs | Total investment in Listed Securities | Total investment in Unlisted Securities |
|--------------------------------------|---------------------------------------|---|
| Grand Total (INR in 'Crores') | 1,07,524.23 | 2,96,529.69 |

Note: Listed Securities - Listed/Proposed to be listed Debt, Listed/Proposed to be listed Equity, Listed/Proposed to be listed equity on SME exchange.

Investment made in equity and debt securities:

| All Category of AIFs | Investments made in equity/equity linked securities (*) | Investment made in debt securities (#) | Investments in units of AIFs/ REITs/InvITs | Security Receipts |
|--------------------------------------|---|--|--|-------------------|
| Grand Total (INR in 'Crores') | 2,55,913.34 | 1,16,381.25 | 12,615.72 | 2,041.63 |

*Investments made in equity/equity linked securities = Listed/Proposed to be listed Equity, Listed/Proposed to be listed equity on SME exchange, Unlisted Equity/Equity Linked

Investment made in debt securities = Securitised Debt, Listed/Proposed to be listed Debt, Unlisted Debt

Note: Listed Securities - Listed/Proposed to be listed Debt, Listed/Proposed to be listed Equity, Listed/Proposed to be listed equity on SME exchange.

Investments made in Start-ups and MSMEs

| All Category of AIFs | Investments made in Medium Enterprise | Investments made in Micro Enterprise | Investments made in Small Enterprise | Investments made in Startup |
|--------------------------------------|---------------------------------------|--------------------------------------|--------------------------------------|-----------------------------|
| Grand Total (INR in 'Crores') | 443.54 | 398.18 | 244.96 | 16,095.12 |

Note: AIF, Company, InvIT, Listed, LLP, Microfinance Institutions, Mutual fund, NBFC, Private Limited, REIT, SPV, Trust, Trust set up by an ARC, VCU are not included.

SHIFT OF AIFs FROM LIGHT-TOUCH TO COMPLIANCE INTENSIVE

AIFs have gained traction in the recent years, to maintain transparency in AIFs operations and to keep protecting the increasing interest of the investors, market regulator (SEBI) has taken steps by way of notifying several regulatory changes in SEBI AIFs Regulations over the years.

Below are the major regulatory reforms in SEBI AIFs Regulations⁵:

| Year | Regulatory reforms/changes |
|-------------|---|
| 2012 & 2013 | <ul style="list-style-type: none"> SEBI (Alternative Investment Funds) Regulations 2012 introduced in May 2012. Periodic reporting to SEBI by AIFs. Risk management framework introduced for Category III AIFs. Calculation of exposures and NAV, obligation of AIFs and custodians in case of breach of limits. |
| 2014 & 2015 | <ul style="list-style-type: none"> Fees, charges, and litigation to be disclosed in PPM for enhanced transparency. Preparation and submission of compliance test report for increased compliance oversight. Guidelines released on overseas investment by AIFs/VCFs to enable more investment options for AIFs. |
| 2017 & 2018 | <ul style="list-style-type: none"> Introduction of online system for registration of AIFs, reporting and filing. Enhanced reporting format for Category III AIFs to capture investments in commodities. Guidelines for AIFs with respect to operation in IFSC, including requirements, conditions and restrictions. |
| 2020 | <ul style="list-style-type: none"> Enhanced and standardized disclosure norms for AIFs to improve transparency. Accountability of members of Investment Committee for investment decisions of the AIF, in case it is a decision-making body. Mandatory performance benchmarking for AIFs. Introduction of templates for PPMs. Mandatory annual audit of PPMs. |
| 2021 | <ul style="list-style-type: none"> Introduced framework for AIFs to invest in units of other AIFs to widen the pool of investors. Applicability of Code of Conduct for Alternative Investment Funds. Introduction of new class of investors — accredited investors. Mandatory filing of PPM through a SEBI-registered merchant banker. Co-investment by investors of AIFs shall be through a co-investment portfolio manager as specified under SEBI (PMS) Regulation 2020. Enhancement of disclosure practices as follows: <ul style="list-style-type: none"> Introduction of investor charter to provide relevant information to investors. Change in KMPs to be disclosed to investors and SEBI. Maintain data on investor complaints in a specified format. |
| 2022 | <ul style="list-style-type: none"> Introduction of special situation funds for investment in special situation assets. Appointment of a compliance officer made mandatory to bring AIFs at par with other investment products. Guidelines for LVFs for Accredited Investors. To standardise operational aspects, issued guidelines governing first close, calculation of tenure, fees, commitment made by manager/ sponsor or change in manager/ sponsor. Eliminated the requirement for an Indian connection for overseas investment to provide more overseas investment opportunities. Priority distribution model to be discontinued to bring all investors on equal footing. |
| 2023 | <ul style="list-style-type: none"> Introduction of direct plan for schemes of AIFs and trail model for distribution commission in AIFs. AIFs shall undertake at least 10% of total secondary market trades in Corporate Bonds by value in a month by using the RFQ platform. All schemes of AIFs shall dematerialise their units in a specified time frame. Standardised approach to valuation of investment portfolio of AIFs. |

⁵ <https://www.crisil.com/content/dam/crisil/our-analysis/reports/Research/documents/2023/12/no-ifs-about-aifs.pdf>

| | |
|-------------|--|
| 2024 | <ul style="list-style-type: none"> • Introduction of a standard reporting format facilitated by AIF Associations. AIFs to submit PPM audit reports online to SEBI. • Notification of Alternative Investment Funds) (Second Amendment) Regulations 2024 wherein: <ul style="list-style-type: none"> - Category I and Category II AIFs may create encumbrance on equity of investee company for the purpose of borrowing. - Every AIF, Manager of AIF, KMP of Manager and AIF shall exercise specific due diligence with respect to investors and investments to prevent facilitation of circumvention of such laws as may be specified by SEBI. - Introduction of the concept of Dissolution Period under Regulation 29B and discontinuation of the concept of Liquidation Scheme under Regulation 29A of the SEBI AIFs Regulations. • SEBI has relaxed the requirements of intimation of changes in terms of PPM of AIFs through Merchant Banker. |
|-------------|--|

Indicative compliances under SEBI AIFs Regulations⁶:

Below is the indicative list of compliances required to be done by AIFs under SEBI AIFs Regulations.

| Compliances | Category of AIF | Monthly/Quarterly Half-yearly/ Annual/Perpetual | Due date |
|---|-----------------|---|--|
| Quarterly Compliance Report | All categories | Quarterly | To be filed within 15 days from the end of the quarter on SEBI SI Portal. |
| Annual Compliance Test Report | All categories | Annual | <ul style="list-style-type: none"> • Submission of CTR to Sponsor / Trustee - within 30 days from the end of the financial year. • Trustee/ Sponsor to provide comments, if any on CTR within 30 days from receipt of CTR. • Making changes in CTR and resubmission of the same to the Trustee / Sponsor - within 15 days from receipt of the observations/ comments, if any. |
| Report to the investors | All categories | Annual | Annual report to be provided to investors of AIF within 180 days from the year end. |
| Disclosure of NAV to the investors | Category III | Not later than Month/Quarter | <ul style="list-style-type: none"> • Not later than Month – Open-ended funds. • Not later than Quarter – Closed ended funds. |
| Valuation of AIFs investments | All categories | <ul style="list-style-type: none"> • Half-yearly; or • Annually if consent of 75% of the investors of AIF (by value) has been obtained. | <ul style="list-style-type: none"> • 31 March/ 30 September. • Annual basis. |
| Obtain performance benchmarking | All categories | A half yearly basis based on the data as on 31 March and 30 September of each year. | <ul style="list-style-type: none"> • Within 6 months from the end of every half-year ending on 31 March; and • Within 45 days from the end of every half-year ending on 30 September. |
| Annual Audit of Accounts of AIFs by a qualified auditor | All categories | Annual | On or before 30 September. |

⁶ List of compliances (including event-based compliances) is not exhaustive and based on the routine compliances applicable to the Schemes under AIF as per PPM, Contribution Agreement and other fund related documents. AIF would require to also do event-based compliances or any other compliances in any other applicable laws, rules, regulations etc., and depending upon sector, fund size etc.

| | | | |
|--|----------------|--|---|
| Dematerialization of units of AIFs | All categories | All AIFs to now issue units in demat form only | - |
| Dematerialization of investments of AIFs (Whether investment made directly in the investee company or is acquired from another entity). | All categories | Perpetual unless exempted | 1 October 2024 |
| NISM Series-XIX-C: Alternative Investment Fund Managers Certification requirement by Key Investment Team of the Investment Manager | All categories | Perpetual | <ul style="list-style-type: none"> • Immediate for all new AIFs • Existing schemes/schemes whose application for launch of scheme was pending as on 10 May 2024 to obtain NISM certification by 9 May 2025 |
| PPM Audit | All categories | Annual | Within 6 months from the end of the Financial Year |
| Limit on investable funds | All categories | Perpetual | <ul style="list-style-type: none"> • Category I and II AIFs not to invest more than 25% of the investable funds in an Investee Company. • Except Large Value Fund (invests not less than INR 70 crores in AIF) can invest upto 50% of the investable funds in an investee company. • Category III AIFs not to invest more than 10% of the investable funds in an Investee Company. |
| Appointment of Compliance officer | All categories | Perpetual | <p>Immediate after registration of an AIF.</p> <p>AIFs shall ensure that IM shall designate an employee or director as Compliance Officer who shall be a person other than CEO of the Manager or such equivalent role or position depending on the legal structure of Manager.</p> |
| Appointment of custodian | All categories | Perpetual | <ul style="list-style-type: none"> • The custodian for a scheme of an AIF shall be appointed prior to the date of first investment of the scheme. • Existing schemes of Category I and II AIFs having corpus less than or equal to INR 500 crore and holding at least one investment as on date of this circular shall appoint custodian on or before 31 January 2025. • All CAT-III AIF |
| Appointment of Registrar and Transfer Agent (RTA) | All categories | Perpetual | Upon obtaining AIF registration |
| Maintenance of continuing interest of Sponsor/ Investment Manager | All categories | Continual basis | Continuing interest |
| Pooling vehicles shall not be created solely for the purpose of investing in an AIF | All categories | Perpetual | - |

| | | | |
|--|----------------|-----------|--|
| Maintain data on investor complaints in a specified format | All categories | Perpetual | - |
| Due diligence with respect to investors and investments | All categories | Continual | - |
| Stewardship Code | All categories | Continual | AIFs to mandatorily follow the Stewardship Code, in relation to their investment in listed equities. |

Indicative event-based compliances under SEBI AIFs Regulations⁷

Below is the indicative list of event-based compliances required to be done by AIFs under SEBI AIFs Regulations.

| Compliances | Due date/Time period/ Compliance to be done |
|---|---|
| Manager and Sponsors disclosures to AIF on their investments in AIF and any conflict of interests | Immediate |
| Reporting to Investors: a. Financial, risk management, operational, portfolio, and transactional information regarding AIF investments. b. Any fees paid to the manager or sponsor; and c. Any fees charged to the AIF or any investee company by an associate of the manager or sponsor. | Periodically - to be determined by the AIF |
| a. Any inquiries or legal actions by legal or regulatory bodies in any jurisdiction. b. Any material liability arising during the AIF's tenure. c. Any breach of placement memorandum or any other fund documents. d. Change in control of the manager or sponsor or investee company; and e. Any significant change in the key investment team. | |
| Immediate Reporting to SEBI for the following disclosures: a. Intimate SEBI of any violations of the AIF regulations or circulars issued thereunder observed from the CTR. b. Misleading / false information or any material change on information already submitted or change in sponsor, manager. c. AIFs shall report the utilisation of overseas investment limits on SEBI intermediary portal. d. Non utilisation / partial utilisation of investment limits within period of 6 months from the date of SEBI approval (validity period) e. Surrender of overseas limit within validity period | |
| Change of category of AIF | Prior approval from SEBI |
| Change in control of the AIF | |
| Any changes to the placement memorandum and in the documents of the fund/scheme including modifications in terms or documents of the AIF / scheme to be intimated to SEBI and the investors. | For material changes – Immediate. |
| Any material alteration to the fund strategy | Consent of at least two-thirds of unit holders by value of their investment in the AIF. |

⁷ List of compliances (including event-based compliances) is not exhaustive and based on the routine compliances applicable to the Schemes under AIF as per PPM, Contribution Agreement and other fund related documents. AIF would require to also do event-based compliances or any other compliances in any other applicable laws, rules, regulations etc., and depending upon sector, fund size etc.

| | |
|---|---|
| A scheme of an AIF to buy or sell investments from or to: i) Associates; or ii) Schemes of AIF managed/sponsored by its manager/sponsored by its manager/sponsor or associates of manager/sponsor; or iii) Investor who has committed to invest at-least 50% of the corpus of the scheme of AIF (to be excluded from voting process at the time of obtaining approval of 75% of the consent of the investors). | Consent of at least 75% of the investors by value of their investment in AIF |
| Valuation of assets of AIF - At each asset level, if there is a deviation of more than 20% between two consecutive valuations or deviation of more than 33% in a financial year. | Manager to inform investors the reasons/factors for deviation, both generic and specific |
| Code of Conduct | AIF, KMP of the AIF, trustee, trustee company, directors of the trustee company, designated partners or directors of the AIF, as the case may be, managers and KMP of managers shall abide by the Code of Conduct as specified in the Fourth Schedule of the SEBI AIFs Regulations. |

Additionally, Trustees of AIFs are obtaining Trustees Compliance Report from the AIFs on a quarterly basis as they are entrusted to ensure compliances of the AIFs.

ONE-TIME REGISTRATIONS REQUIRED BY AIFs

Upon the registration of AIF by SEBI, below are the one-time registrations required to be obtained by AIFs.

1. Financial Intelligent Unit (FIU) 2.0 under Prevention of Money Laundering Act, 2002 (PMLA)
2. CKYC Registration on CERSAI Portal
3. KRA Registration etc.

CODES AND POLICIES TO AIFs/ INVESTMENT MANAGER (IM) OF AIFs

AIFs and/or IM of AIFs are required to be prepared policies such as KYC/ Anti-Money Laundering (AML)/ Combating Financing of Terrorism (CFT) Policy, Conflict management policies and risk management policies (Policy to be made before initial closing of the fund), The management, financing and disposal policies of the Fund, Liquidation Management Policy, Insider Trading Policy, Investment Policies and strategy and Policies and procedures of valuation as per Regulation 20(8) and 23(6) and of SEBI AIFs Regulations, Internal policies as per the fund documents of AIFs and such other policies as required to be prepared by AIFs/IM of AIFs as per applicable laws.

AIFs/IM are required to abide by Code of conduct as per Fourth Schedule of the SEBI AIF Regulations, 2012. AIFs are mandatorily follow the Stewardship Code, in relation to their investment in listed equities.

AIF industry is consistently evolving and growing, and comprises three categories – Category I, Category II and Category III AIFs as per SEBI AIFs Regulations. Category II AIFs have grown at a healthy pace. Majority of the AIFs are registered with SEBI are Category II AIFs.

INDICATIVE COMPLIANCES UNDER FOREIGN EXCHANGE MANAGEMENT ACT, 1999

AIFs with foreign investments are required to comply with the Foreign Exchange Management Act, 1999, FDI Policy of 2020 issued by Department for Promotion of Industry and Internal Trade (DPIIT), Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 and Foreign Exchange Management (Mode and Payment and Reporting of Non-Debt Instruments) Regulations, 2019. Indicative compliances are listed as below:

| Compliances | Due date |
|-------------|---|
| Form InVI | Within 30 days from the date of allotment of units |
| Form DI | On FIFP ⁸ Portal – Within 30 days from the date of receipt of the investment. On FIRMS Portal - Within 30 days from the date of allotment of securities |

⁸ FIFP means 'Foreign Investment Facilitation Portal' of DPIIT.



| | |
|---|---|
| FLA return | By 15 July (in excel format as prescribed by RBI) |
| Overseas Investment by AIF (AIFs may invest in equity and equity linked instruments only of offshore venture capital undertakings, subject to overall limit of USD 1500 million) | <ul style="list-style-type: none"> AIF to report the utilization of the overseas limits within 5 working days of such utilization on SEBI intermediary Portal. https://silogin.sebi.gov.in/global-protect/login.esp?token=1 Sale/divestment details of the overseas investments to be submitted by AIF to SEBI within 3 working days of the divestment. |

OTHER APPLICABLE LAWS

AIFs/IM are required to comply other applicable securities laws, rules and regulations etc., such SEBI (Prohibition of Insider Trading) Regulations, 2015, Prevention of Money Laundering Act, 2002, Sector specific laws etc.

CONCLUSION

An AIF Industry has done exponential growth in terms of increasing domestic and foreign capital flow, increasing investment opportunities and contributing significantly to the capital market of India and has enabled all the stakeholders in the AIF ecosystem.

Various steps taken by SEBI in regulatory reforms under SEBI AIF Regulations are aimed at protecting, increasing and building investor confidence, ease of compliances and to boost capital market and development of the Indian economy.

Over the years, noteworthy changes have been introduced to SEBI AIFs Regulations to make it robust and competent and compliance intensive.

As a good governance practice and to boost investors’ confidence and various other stakeholders, AIFs players and Investment Managers of AIFs should get the health check/due diligence of their compliances, investors, and its investments to avoid any regulatory gaps/oversight and with the advancement of technology will give a sharp fillip to growth in the AIF Industry.