

ALTERNATIVE INVESTMENT FUNDS



An Alternative Investment Funds (“AIFs”) in India are governed by the Securities and Exchange Board of India (Alternative Investment Regulations), 2012 (“AIF Regulations”) and regulated by the Securities and Exchange Board of India (“SEBI”). The AIF Regulations regulate the registration, operation and winding up of the AIFs. In this primer, we have covered common queries in relation to AIFs.

**1. What is an AIF?**

As per the AIF Regulations, an AIF means any privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing in accordance with a defined investment policy for the benefit of its investors. An AIF can be established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate. AIF does not include funds covered under the SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of the Board to regulate fund management activities.

**2. What are the various categories of an AIF?**

An entity can be registered as an AIF under any of the 3 (three) categories listed out in the table below:

Category I AIF	Category II AIF	Category III AIF
This category includes AIFs which invests in start-ups, early-stage venture capital projects, social venture, small and medium sized enterprises (“SME”), infrastructure projects, or other sectors which the government or regulators consider as socially or economically desirable. Category I AIFs include venture capital funds (including angel	This category includes AIFs which does not fall in Category I AIF and Category III AIF. Category II AIFs include private equity funds (PE funds) or debt funds, for which no specific incentives or concessions are given by the government or any other regulator.	This category includes AIFs which employ different trading strategies like arbitrage, margin trading and derivative trading. This category can make investments in both unlisted and listed derivatives through leverage as per the AIF Regulations. Category III AIFs include hedge funds or funds which trade with a view to make short term returns, etc., for

<p>funds), SME funds, social venture funds, infrastructure funds and special situation funds.</p>		<p>which no specific incentives or concessions are given by the government or any other regulator.</p>
<p>The schemes of a Category I AIF are required to be close ended and shall have a minimum tenure of 3 (three) years.</p>	<p>The schemes of a Category II AIF are required to be close ended and shall have a minimum tenure of 3 (three) years.</p>	<p>The schemes of a Category III AIF may be open or close ended.</p>
<p>A Category I AIF is not permitted to invest more than 25% (twenty-five percent) of its investable funds in a single investee company. Provided that large value funds for accredited investors of Category I AIFs may invest up to 50% (fifty percent) of its investable funds in an investee company.</p>	<p>A Category II AIF is not permitted to invest more than 25% (twenty-five percent) of its investable funds in a single investee company. Provided that large value funds for accredited investors of Category II AIFs may invest up to 50% (fifty percent) of its investable funds in an investee company.</p>	<p>Category III AIFs not permitted to invest more than 10% (ten percent) of the investable funds in an investee company, directly or through investment in units of other AIFs and the large value funds for accredited investors of Category III AIFs may invest up to 20% (twenty per cent) of the investable funds in an investee company, directly or through investment in units of other AIFs.</p> <p>Provided that for investment in listed equity of an investee company, Category III AIFs may calculate the investment limit of 10% (ten per cent) of either the investable funds or the net asset value of the scheme and large value funds for accredited investors of Category III AIFs may calculate the investment limit of 20% (twenty per cent) of either the investable funds or the net asset value of the scheme, subject to the conditions specified by SEBI from time to time.</p>
<p>A Category I AIF shall invest in investee companies, venture capital undertaking, special purpose vehicles, limited liability partnerships or in units of other category I AIFs of the same sub-category or in units of category II AIFs as specified in the regulations. Category I AIF shall not borrow funds directly or indirectly and shall not engage in leverage except for meeting temporary funding requirements for not more than 30 (thirty) days, not more than 4 (four) times in a</p>	<p>A Category II AIF shall invest primarily in unlisted investee companies or in the units of category I or other category II AIFs. Category II AIF shall not borrow funds directly or indirectly and shall not engage in leverage except for meeting temporary funding requirements for not more than 30 (thirty) days, not more than 4 (four) times in a year and not more than 10% (ten percent) of the investable funds.</p>	<p>A Category III AIF may invest in securities of listed or unlisted investee companies or derivatives or units of other AIFs or complex or structured products or deal in goods received in delivery against physical settlement of commodity derivatives. Category III AIF may engage in leverage or borrow subject to consent from the investors in the fund and subject to a maximum limit, as may be specified by SEBI.</p>

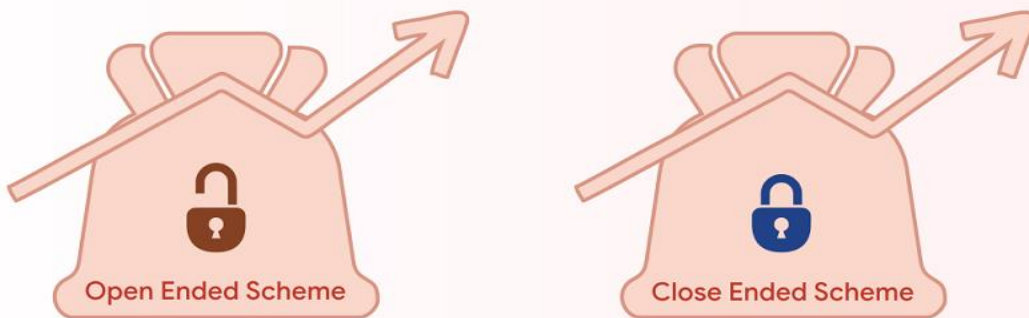
<p>year and not more than 10% (ten percent) of the investable funds.</p>		
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**3. What is the minimum corpus of an AIF?**

As per the AIF Regulations, a corpus is the total amount of funds committed by investors to the AIF by way of a written contract or any such document as on a particular date. As per AIF Regulations, the minimum corpus for an AIF shall be INR 200,000,000 (Indian Rupees Two Hundred Million). In case of an angel fund, the minimum corpus is INR 50,000,000 (Indian Rupees Fifty Million).

**4. What is open ended and close ended AIF?**

AIF Regulations does not provide definition for open ended and close ended AIF. However, as per the general understanding, open-ended AIF can be understood as the scheme that offer new units to the investors on a continuous basis while, closed-ended AIF are the mutual funds, which offer new units to investors for a limited period only.





## 5. Who is an accredited investor? What are the eligibility factors?

As per the AIF Regulations, an accredited investor means any person who is granted a certificate of accreditation by an accreditation agency. The AIF Regulations prescribe a minimum criterion with respect to annual income and net worth for an investor who might be an individual, HUF, family trust, sole proprietor, body corporate or a trust other than family trust to be eligible for being an accredited investor.

## 6. Are there any regulatory limits on number of investors and investment amount for AIFs?

As per the AIF Regulations, an AIF is not permitted to make an invitation to the public to subscribe to its units/securities. Further, an AIF can raise funds from its investors only by issuance of units/securities through private placement.

An AIF (other than angel fund) shall not have more than 1,000 (one thousand) investors in any scheme. In case of an angel fund, no scheme shall have more than 200 (two hundred) angel investors.

An AIF may accept the following as joint investors for the purpose of investment of not less than INR 10,000,000 (Indian Rupees Ten Million):

- a) an investor and his/her spouse;
- b) an investor and his/her parent; and
- c) an investor and his/her daughter/son.

An investor is required to invest a minimum of INR 10,000,000 (Indian Rupees Ten million) in AIF. The above-mentioned investment limit may be reduced for employees and directors of the investment manager subject to receipt of a minimum investment of INR 2,500,000 (Indian Rupee Two Million and Five Hundred Thousand).

As per the AIF regulations, an angel fund is permitted to raise funds by way of issue of units to angel investors. Angel fund shall accept an angel investor for the purpose of investment of not less than INR 2,500,000 (Indian Rupee Two Million and Five Hundred Thousand) for a maximum period of 5 (five) years.

## 7. Who is a sponsor of the AIF? Are there any obligations of a sponsor under AIF Regulations?

A sponsor of an AIF is any person who sets up the AIF including the promoter in case of a company and designated partner in case of a limited liability partnership. The investment manager may also be the same as the sponsor of the fund.

As per AIF Regulations, the investment manager or the sponsor will have a continuing interest in the AIF of the lesser of (i) 2.5% (two point five percent) of the corpus; and (ii) INR 50,000,000 (Indian Rupees Fifty Million) for Category I and II AIFs, and the lesser of (i) 5% (five percent) of the corpus; and (ii) INR 100,000,000 (Indian Rupees One hundred Million) for Category III AIFs. For angel funds, the minimum continuing interest shall be the lesser of (i) 2.5% (two point five percent) of the corpus; or (ii) INR 5,000,000 (Indian Rupees Five Million), whichever is lesser. The minimum continuing interest of the sponsor or investment manager cannot be through a waiver of management fees.

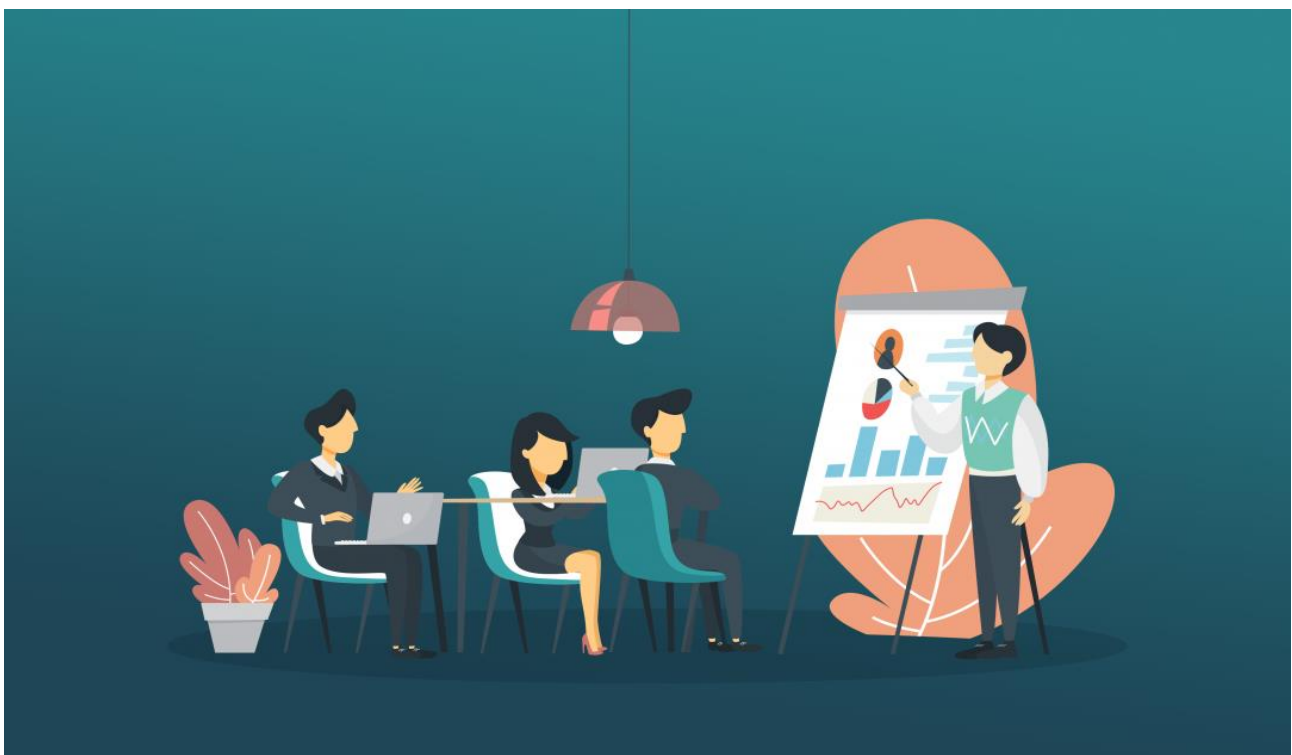
## 8. Who is a manager? Are there any obligations and responsibilities of a manager under the AIF Regulations?

A manager is defined under the AIF Regulations to mean, any person or entity who is appointed by the AIFs to manage its investments. As per the AIF Regulations, a manager may be the same as the sponsor of the fund in certain cases.

The AIF Regulations impose certain obligations on the manager including:

- a) addressing all investor complaints,
- b) providing SEBI with the information sought,
- c) maintaining records,
- d) taking necessary steps to address conflict of interest,
- e) ensuring transparency, and
- f) ensuring compliance by the AIF with the 'Code of Conduct' prescribed in the fourth schedule to the AIF Regulations.

Moreover, as per the AIF Regulations, the responsibilities of a manager include compliance of decisions of the AIFs with regulations, terms of the placement memorandum, agreements entered into with investors, fund documents, applicable laws and the internal policies of the AIFs, as applicable.







## 9. What is the process for registration of an entity as AIF with SEBI?

The entity is required to file an application before SEBI for the purposes of registration as an AIF.

The application is to be mandatorily made in the prescribed 'Form A' attached in the first schedule to the AIF Regulations specifying the category under which the AIF is to be registered.

For the purpose of grant of certification, SEBI necessarily considers if the entity is permitted to carry on the activity of an AIF as per its incorporation documents and the said documents are duly filed and registered under the laws to which it is amenable. Moreover, the SEBI also considers if the applicant, sponsor, and manager are fit and proper persons based on the criteria specified in Schedule II of SEBI (Intermediaries) Regulations, 2008.

The entity is also required to submit along with the form, a copy of the draft private placement memorandum for inviting investment into the AIF to SEBI. In addition, draft formats of the investment management agreement along with the investment manager and contribution agreement with the prospective investor are also required to be submitted to SEBI at the time of registration of the AIF.

## 10. What is private placement memorandum? Are there any regulatory requirements in relation to an AIF's private placement memorandum?

Private Placement Memorandum ("PPM") is considered as the information memorandum for AIFs which contains all the necessary information about the AIFs. PPMs are required to contain all material information about the AIF including with respect to, background of the key investment team of the investment manager, targeted investors, fees and all other expenses proposed to be charged, tenure of the fund or scheme, conditions or limits on redemption, investment strategy, risk management tools and parameters employed, key service providers, conflict of interest and procedures to identify and address them and disciplinary history, the terms and condition son which the investment manager offers investment services, its affiliations with other intermediaries and manner of winding up of the AIF or the scheme.

SEBI has also released formats of PPM for each category of the AIF, which are to be followed by the prospective applicants for registration as AIFs. The formats include the minimum level of information which

are required to be included in a private placement memorandum. An applicant may seek exemption from following the format in the following cases:

- a) An angel fund may seek exemption from SEBI.
- b) An AIF or scheme of an AIF in which each invest or commits to a minimum capital contribution of INR 700,000,000 (Indian Rupees Seven Hundred Million) or USD 10,000,000 (United States Dollars Ten Million) or equivalent, in case of capital commitment in non-INR currency.

### **11. Is there any dispute resolution mechanism specified under the AIF Regulations?**

As per the AIF Regulations, the AIF, by itself or through its manager or sponsor is required to specify the procedure for dispute resolution arising between the investors, AIF, manager or sponsor. The process may be through arbitration or any such mechanism as mutually agreeable between the investors and the concerned AIF.

### **12. What is the process for winding up of an AIF?**

As per the AIF regulations, PPM of an AIF must include information on the manner of winding up of the fund. An AIF can be wound up in the following cases:

- a) on expiry of the tenure of the AIF/ scheme as mentioned in the PPM;
- b) if the trustee or the trustee company directs in the interest of the investors;
- c) if 75% (Seventy-Five percent) of investors by the value of their investment pass a resolution for
- d) winding up at a meeting of unit holders; or
- e) if SEBI directs in the interest of the investors.

Further, an AIF set up as a limited liability partnership, as a company, as a body corporate shall be wound up in accordance with the provisions of the respective statutes under which they were constituted. It is the duty of the trustee or the trustee company or the director or designated partners to intimate the investors and SEBI, the circumstances leading to winding up. No investment shall be made from the fund after receiving such intimation. The assets of the AIF are required to be liquidated in accordance with the PPM and the proceeds are to be distributed among the investors after satisfying all liabilities, within 1 (one) year from the date of intimation. The certificate of registration has to be surrendered back to the SEBI on winding up.

### **13. What are the conditions under which an AIF will be said to be liable for default?**

As per the AIF Regulations, an AIF would be said to be in default when it:

- a) contravenes the provisions of the SEBI Act, 1992, or the AIF Regulations.
- b) fails to furnish or furnishes false / misleading information to SEBI.
- c) does not submit periodic reports or returns as required.
- d) does not co-operate in any enquiry, inspection or investigation conducted by SEBI.

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