Alternative Investment Funds (AIFs)

Why in news?

The Reserve Bank of India (RBI) has revised draft guidelines for investments by regulated entities (REs) in Alternative Investment Funds (AIFs), aiming to enhance oversight and prevent potential misuse.

> *A Regulated Entity (RE) is any financial institution that operates under the regulatory framework of the RBI, E.g., Banks, NBFCs.*

- **Alternative Investment Fund (AIF)** - It is a **privately pooled investment scheme** that collects funds from investors (Indian or foreign) to invest in accordance with a **defined investment policy**.
- AIFs are **not mutual funds** and are **regulated by SEBI** under the SEBI (AIF) Regulations, 2012.
- AIFs can be invested in **unlisted companies**, **real estate**, **start-ups**, and **other non-traditional assets**.
- **High Net-Worth Individuals (HNIs)** and **institutional investors** are the main participants.
- **It is not available to retail investors**.
- **Types of AIFs** – There are three categories of AIF as per SEBI,
- **Category I AIF** – Promotes start-ups and socially beneficial sectors.
    - Examples: Venture capital funds, Small and Medium Enterprises (SME) funds, infrastructure funds.
    - Enjoys certain tax and regulatory incentives.
- **Category II AIF** – Risk free and do not undertake leverage except for day-to-day operational needs.
    - Examples: Private equity funds, debt funds.
- **Category III AIF** – Employ diverse or complex trading strategies.
    - Examples: Hedge funds, PIPE (Private Investment in Public Equity) funds.
- **Significance –** It helps to **channel capital** into **non-traditional sectors** and facilitates **growth funding** for start-ups and MSMEs.

Recent RBI Proposals

- **Investment caps** – A single RE can invest a **maximum of 10%** in a **single AIF scheme**.
- Collective investment by all REs in a single AIF scheme is capped at **15%**.
- **Threshold-based regulation** – RE’s must set aside ***100% of that investment as a safety buffer*** if,

    - The investment in AIF is more than 5% and,
    - The RE has downstream exposure to a company.

  Downstream exposure means that if a RE provides loan through AIF to a company that already financially related to it.

- **Exemptions** - Equity shares and certain convertible instruments are excluded from the downstream exposure restrictions.

References

1. SEBI| Alternative Investment Funds
2. The Indian Express| RBI revises rules for investment in AIF

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