SEBI AIF Regulations – An Overview

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Categories of AIFs

- The SEBI (AIF) Regulations were notified on May 21, 2012

Categories of AIF

Category I AIF

Invest in (i) start-up or (ii) early stage or (iii) social ventures or (iv) other sectors, socially or economically desirable.

Includes:

- VCFs
- SME Funds
- Social Venture Funds
- Infrastructure Funds
- Other AIFs as may be specified

Category II AIF

Residual Category which do not undertake leverage / borrowing other than to meet day-to-day operational requirements.

Includes:

- Private Equity Funds
- Debt funds

for which no specific incentives or benefits are provided by the Government

Category III AIF

Employ diverse or complex trading strategies and may employ leverage, including investment in derivatives.

Includes

- Hedge funds
- Funds trading with a view to make short-term gains
- Other open-ended funds for which no specific incentives or concessions are given by the Government

AIF Regulations – Key features

- AIFs defined as privately pooled investment vehicles constituted as trusts, companies, LLPs or as a body corporate; family trusts, holding companies, ESOP trusts etc not to be considered as AIFs
- AIF to be established by a sponsor and managed by a fund manager; sponsor and fund manager of an AIF can be the same person
- Key investment team of the fund manager to have adequate experience; fund manager to have necessary infrastructure and manpower to discharge its activities
- Minimum corpus of AIFs – Rs 20 crores; minimum ticket size – Rs 1 crore for investors and Rs 25 lakhs for employees and directors of manager / sponsor
- Permitted to raise monies from overseas; however, no corresponding change under Indian exchange control regulations
- Category I and II AIFs to be close-ended
- Separate investment conditions specified for each category of AIFs
- FVCI investment permitted only in Category – I – VCFs

Category III AIFs

- Sponsor commitment – 5 percent of corpus or Rs 10 crores, whichever is less; double the sponsor commitment prescribed for Category I and II AIFs
- Permitted to be open-ended or close-ended
- Investment in a single investee company capped at 10 percent of corpus vis-à-vis 20 percent in case of Category I and II AIFs
- Investment conditions:
  - May invest in listed or unlisted securities or derivatives or complex and structured products
  - May engage leverage or borrow funds, subject to a maximum limit, as specified by SEBI; no limit prescribed by SEBI till date
- SEBI may issue directions regarding operational standards, conduct of business rules, prudential requirements, restrictions on redemption and conflicts of interest; no such directions issued by SEBI till date
- Mandatorily required to appoint a custodian
- NAV calculation to be independent of fund management function; to be disclosed to investors on quarterly basis by close-ended funds and monthly by open-ended funds
- Quarterly reports to investors containing prescribed information within 60 days from the end of the relevant quarter

AIFs – Tax considerations

- Dividend distribution tax may apply to distributions by AIFs formed as companies
- Winding up of company AIFs can be time consuming
- Budget 2013 has accorded pass through status only to Category I AIFs that qualify as VCFs as is defined in the SEBI AIF Regulations, albeit, subject to the following conditions:
  - (i) The units of or shares in the AIF should not be listed on any recognized stock exchange.
  - (ii) At least 2/3rd of its investible funds should be invested in unlisted equity shares or equity linked instruments of venture capital undertakings; and
  - (iii) The AIF should not invest in any associated company.
- However, pass through status for other AIFs constituted as trusts may be achievable
- Budget 2013 has provided that shares issued by a closely held Indian company, at a premium, to Category I AIFs that qualify as VCFs as is defined in the SEBI AIF Regulations not to be taxable tax in the hands of the Indian investee company. No carve out for other types of Category I AIFs as well as Category II and Category III AIFs
- Additional tax compliance burden for AIFs not accorded pass through status