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DRAFT AIF REGULATIONS 2011

AIF regulations - the backdrop

- Current regulatory framework addresses Mutual Funds, Collective Investment Schemes, Portfolio Managers and VCFs
- SEBI's concerns with the existing VCF regulations stem from the fact that:
  - VCF regulations were intended to encourage funding of early stage companies; in practice, VCFs do not confine their investments to such companies
  - Registration is not mandatory for all pools of private capital; this creates regulatory arbitrage
  - Investment restrictions and regulatory concessions cannot be appropriately targeted
- The philosophy underpinning the AIF regulations is:
  - To ensure stability of the financial markets and mitigate systemic risk
  - To permit a better targeting of regulatory concessions
  - To provide investor protection

Overall construct

- All privately pooled vehicles to be registered
- Registration based on investment strategy:
  - VCF
  - PIPE
  - PE
  - Infrastructure
  - Debt
  - Real Estate
  - SME
  - SVF
  - Strategy
- Investment norms stipulated for each category

Scope

- An AIF has been defined to mean:
  - The pooling or raising of private capital
  - From institutional or high net worth investors
  - With a view to investing the funds in accordance with a defined investment policy
- High net worth investors have been defined to mean:
  - individuals or corporate or any other legal entity located in India or overseas
  - who invest in AIF for a value of not less than Rs 1 crore
- Registration required for “all AIFs in securities market, irrespective of their legal domicile which collects its fund from institutional and HNIs in India or the manager of such fund who manages the fund for investments in India”
- Registration subject to SEBI’s satisfaction that AIF meets eligibility criteria
- Managers may require registration under Investment Advisor regulations to be announced

Impact on existing funds

- Regulations stipulate that all existing pooled vehicles must apply for registration within a 6 month period
- Funds already registered as VCFs will continue to be governed by the current regulations until the fund or scheme is wound up

Entity options

- An AIF may be established in the form of a:
  - Trust
  - LLP
  - Company
- Number of investors in a trust capped at 1,000; number of investors in an LLP and a company capped at 50

Sponsor obligations

- No sponsor obligations prescribed under current regulations
- AIF regulations stipulate a Sponsor contribution:
  - Of at least 5% of the Fund
  - Which cannot be by way of waiver of management fees
  - Which shall be locked in till the redemption by last investor in the fund
- Sponsor to "take up" any un-liquidated investments at the end of Fund's tenor
- Key persons are required to devote substantially all their business time to the fund

Fee construct

- No prescriptions with regard to fees and carry currently
- The AIF regulations provide that SEBI may specify criteria for charging performance based fees
- The explanatory note suggests that fee disclosure requirements may be aligned with those applicable to portfolio managers
- Portfolio managers are required to make a detailed fee disclosure – this *inter-alia* requires illustration of the fee structure under three scenarios - when the portfolio increases by 20%, when the portfolio decreases by 20% and when the portfolio remains unchanged - on a sample portfolio of Rs 10 lacs over a 1 year period

Investment conditions

Type of Fund	Existing VCF	Strategy fund
Investment in any single VCU	Upto 25% of corpus	No cap
Instruments to invest in and caps:		
Unlisted equity / equity linked instruments	At least 2/3rd of corpus must be invested in VCUs	No cap
Listed equity	No more than 1/3rd of corpus	No cap
Debt / Debt instruments	No more than 1/3rd of corpus and only if VCF holds equity investment in the VCU	No cap
Derivatives	Not permitted	No restrictions
Investment in 'Associate companies'	Not permitted	No restrictions

Other matters 1/2

- Fund size to be specified at application; 25% increase with SEBI approval
- No minimum number of investors specified – also the case under current regulations
- Minimum investor commitment set at greater of 0.1% of fund size or Rs 1 crore; raised from Rs 5 lacs currently
- Minimum fund size = Rs 20 crores up from Rs 5 crores stipulated currently
- AIFs must be close ended with a minimum tenure of 5 years; the maximum tenure has not been prescribed - no such prescription currently
- In addition to currently applicable general obligations, AIFs will have *inter-alia* to:
  - Issue a PPM, which currently is not mandatory
  - Provide SEBI information for systemic risk purposes
  - Appoint a custodian for safe keeping of securities if assets under management exceed Rs 500 crores
  - Establish and implement written policies and procedures to identify, monitor and appropriately mitigate conflicts of interest
  - Make detailed disclosures to investors about the AIF and portfolio companies
  - Provide investors with estimates of quarterly projections of capital calls and distributions

Other matters 2/2

- Any alteration of the strategy requires consent of 75% of the beneficiaries / unit holders
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  - Provide SEBI information for systemic risk purposes
  - Appoint a custodian for safe keeping of securities if assets under management exceed Rs 500 crores
  - Establish and implement written policies and procedures to identify, monitor and appropriately mitigate conflicts of interest
  - Make detailed disclosures to investors about the AIF and portfolio companies
  - Provide investors with estimates of quarterly projections of capital calls and distributions
- Onerous record keeping obligations - valuation policies and practices; trading practices or investment or trading strategies; analytical or research methodologies. Data to be maintained for a period of 5 years after the winding up of the fund; currently, books and records to be maintained for 8 years

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