Nanubhai Desai & Co.

Alternative Investment Funds

About Nanubhai Desai & Co.

Nanubhai Desai & Co., established in 1950 in Mumbai, has evolved into a well-recognized high quality personalized services firm. Our extensive knowledge and expertise across various service areas, including Audit and Assurance, Direct Taxes, Accounting, International Tax, and Consultancy services, enable us to offer a "One Stop Platform" by setting a benchmark of excellence in each domain.

With years of experience, we cater to a diverse clientele, including multinational companies (MNCs), foreign companies and their Indian subsidiaries, as well as public and private enterprises spanning industries such as hospitality, trading, fund & private wealth management, IT, and more. Our team comprises dedicated professionals with diverse skills and proficiency, capable of serving clients of all sizes across different sectors.

NDCo embodies a harmonious mix of seasoned expertise and youthful vigour, united by a shared vision of delivering exceptional services and unwavering support to our clients. It's a source of great professional pride that we have attained high level of trust and confidence of our clients.

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TERMINOLOGY GUIDE

AIF	Alternative Investment Fund
AML	Anti-Money Laundering
ESG	Environmental, Social and Governance
FEMA	Foreign Exchange Management Act
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
HNI	High Net Worth Individual
InvIT	Infrastructure Investment Trust
KYC	Know Your Customer
LLP	Limited Liability Partnership
NAV	Net Asset Value
QFI	Qualified Foreign Investor
QIB	Qualified Institutional Buyer
RBI	Reserve Bank of India
REIT	Real Estate Investment Trust
SEBI	Security Exchange Board of India
SME	Small Medium Enterprise
TDS	Tax Deduction at Source

1. INTRODUCTION

An Alternative Investment Fund (AIF) in India refers to a privately pooled investment vehicle that is not regulated under traditional investment laws and is distinct from mutual funds, pension funds, and insurance funds. AIFs serve as alternative investment avenues for sophisticated investors seeking exposure to a diverse range of asset classes beyond traditional stocks, bonds, and cash equivalents.

AIFs are governed by the Securities and Exchange Board of India (SEBI) under the SEBI (Alternative Investment Funds) Regulations, 2012. These regulations define AIFs as funds that collect funds from investors for the purpose of investing in accordance with a defined investment policy for the benefit of investors. They operate on a principle of pooling investor funds with the aim of generating attractive returns while managing risk through diverse investment strategies.

Key Characteristics Distinguishing AIFs from Traditional Investment Vehicles:

i. *Regulatory Framework*: AIFs operate under a separate regulatory framework established by SEBI, distinct from traditional investment vehicles like mutual funds. This framework offers greater flexibility in investment strategies and structures, catering to sophisticated investors with higher risk appetites.

ii. *Investment Strategies*: AIFs employ a wide range of investment strategies including private equity, hedge funds, real estate, infrastructure, venture capital, distressed assets, and other alternative asset classes. This diversity allows investors to access unique investment opportunities not typically available through traditional avenues.

iii. *Investor Profile*: AIFs cater to accredited investors such as high net worth individuals, family offices, institutional investors, and qualified foreign investors who possess the requisite knowledge and experience to understand and evaluate complex investment opportunities.

iv. *Risk and Return Profile*: AIFs typically target higher returns compared to traditional investment vehicles but may also entail higher risks due to their exposure to alternative asset classes, illiquidity, leverage, and other factors. Investors in AIFs are expected to conduct thorough due diligence and assess risk-return profiles before investing.

v. *Lock-In Periods and Liquidity*: AIFs often have longer lock-in periods and limited liquidity compared to traditional investment funds. Investments in AIFs may be subject to specific holding periods before investors can redeem their stakes, depending on the fund's investment strategy and underlying assets.

vi. *Fee Structure*: AIFs typically charge performance-based fees in addition to management fees, aligning the interests of fund managers with those of investors. This fee structure incentivizes fund managers to deliver superior investment performance while generating income for the management company.

2. REGISTRATION OF AIF

The registration process for Alternative Investment Funds (AIFs) with the Securities and Exchange Board of India (SEBI) is a crucial step ensuring compliance with regulatory norms and facilitating investor confidence. Here's an overview of the registration process, requirements, and post-registration obligations:

I. Overview of the Registration Process:

i. *Preparation and Submission of Application*: The sponsor or manager of the AIF, along with other key entities involved, such as trustees, custodians, and investment managers, need to prepare and submit an application to SEBI for registration. The application should include details regarding the fund structure, investment strategy, key personnel, and compliance with SEBI regulations.

ii. *SEBI Examination and Approval*: SEBI thoroughly examines the application to ensure compliance with regulatory requirements and assess the suitability of the fund's structure, investment objectives, and risk management practices. Upon successful evaluation, SEBI grants registration to the AIF, subject to certain conditions.

iii. *Issuance of Certificate of Registration*: Upon approval, SEBI issues a Certificate of Registration to the AIF, enabling it to commence operations and raise funds from investors. The certificate serves as evidence of compliance with SEBI regulations and provides legal authorization to conduct activities as an AIF.

II. Requirements and Criteria for Registration:

Eligibility Criteria: AIFs seeking registration with SEBI must meet certain eligibility criteria, including:

→ Compliance with SEBI (Alternative Investment Funds) Regulations, 2012.

→ Appointment of a custodian, trustee, and investment manager as per regulatory requirements.

→ Fulfillment of minimum net worth requirements for the sponsor, manager, and trustee, as specified by SEBI.

III. Disclosure and Documentation: A comprehensive application needs to be submitted to SEBI, including:

→ Details of the fund structure, investment strategy, and targeted investor base.

→ Information on key personnel, including sponsors, trustees, and investment managers, along with their credentials and experience.

→ Compliance with SEBI regulations regarding investor protection, disclosure standards, and risk management practices.

IV. Compliance and Regulatory Obligations Post-Registration:

→ Ongoing Disclosures: AIFs are required to make periodic disclosures to SEBI and investors, including financial statements, performance reports, and any material changes in the fund's operations.

→ Investor Communication: AIFs must maintain transparency and communicate effectively with investors, providing regular updates on fund performance, investment activities, and material developments.

→ Compliance with SEBI Regulations: AIFs are obligated to adhere to SEBI regulations, guidelines, and circulars issued from time to time, ensuring compliance with regulatory norms and best practices.

→ Risk Management: AIFs are expected to implement robust risk management frameworks, including risk identification, assessment, mitigation, and monitoring mechanisms, to safeguard investor interests and preserve fund integrity.

3. CHOICE OF POOLING VEHICLE

The selection of an appropriate pooling vehicle is a critical decision for AIFs in India, as it determines the fund's legal structure, operational framework, and regulatory compliance. Here's a discussion on various pooling vehicles available for AIFs, factors influencing the choice, and a comparative analysis of different pooling structures:

I. Various Pooling Vehicles Available for AIFs:

i. *Trusts:* AIFs can be structured as trusts, where the sponsor acts as the settlor, appoints trustees to manage the trust property, and beneficiaries are the investors in the fund. Trusts offer flexibility in operations, ease of administration, and tax efficiency.

ii. *Companies:* AIFs may also be structured as companies, either as private limited or public limited entities. Companies provide limited liability protection to investors, centralized management through a board of directors, and the ability to raise capital through equity or debt financing.

iii. *Limited Liability Partnerships:* AIFs can opt for LLP structures, combining the features of both companies and partnerships. LLPs offer limited liability protection to partners, tax efficiency, and flexibility in management and operations.

iv. *Partnerships:* AIFs may be structured as traditional partnerships, where the partners have unlimited liability for the fund's obligations. Partnerships offer flexibility in profit-sharing arrangements, decision-making processes, and operational control.

II. Factors Influencing the Choice of Pooling Vehicle:

i. *Legal and Regulatory Compliance:* The choice of pooling vehicle depends on compliance with regulatory requirements imposed by SEBI and other relevant authorities. Each vehicle has specific regulatory obligations that must be fulfilled by the AIF.

ii. *Investor Preferences*: The choice of pooling vehicle may be influenced by investor preferences, risk profiles, and expectations regarding governance, transparency, and liquidity. Investors may have specific preferences for certain legal structures based on their familiarity and comfort level.

iii. *Operational Considerations:* Factors such as ease of administration, flexibility in management, tax implications, and cost-effectiveness play a crucial role in determining the pooling vehicle. AIFs need to evaluate the operational complexities associated with each structure and choose the one that aligns with their operational objectives.

iv. *Liability Protection:* Limited liability protection is a key consideration for investors and sponsors. Pooling vehicles offering limited liability protection shield investors and sponsors from personal liability, enhancing investor confidence and risk management.

III. Comparative Analysis of Different Pooling Structures:

i. *Trusts vs. Companies:* Trusts offer greater flexibility in operations, tax efficiency, and ease of administration compared to companies. However, companies provide limited liability protection to investors & centralized management through a board of directors.

ii. *Companies vs. LLPs:* Companies offer limited liability protection and access to equity financing through share capital, whereas LLPs provide flexibility in management, tax efficiency, and pass-through taxation benefits.

4. CATEGORIES OF AIF

Alternative Investment Funds (AIFs) in India are categorized into three distinct categories based on their investment objectives, strategies, and regulatory framework. Each category has specific investment strategies and permissible activities, as well as regulatory requirements imposed by the Securities and Exchange Board of India (SEBI). Here's an overview of each category:

A. Category I AIFs:

I. Explanation:

Category I AIFs include funds that invest in startups, early-stage ventures, social ventures, small and medium-sized enterprises (SMEs), infrastructure projects, and other sectors or areas that have the potential for positive social or economic impact. These funds focus on providing capital to businesses or projects that contribute to economic growth, employment generation, and social welfare.

II. Investment Strategies and Permissible Activities:

→ Category I AIFs primarily invest in sectors such as agriculture, infrastructure, healthcare, education, renewable energy, microfinance, and other socially relevant sectors.

→ Permissible activities include investments in equity, debt, hybrid instruments, structured products, and other securities issued by eligible companies or projects that align with the fund's social or economic objectives.

→ Category I AIFs may also engage in venture capital financing, angel investing, impact investing, and other forms of early-stage or growth capital funding.

III. Regulatory Framework:

→ Category I AIFs are subject to a relatively lighter regulatory framework compared to other categories, reflecting the policy objective of promoting investments in socially and economically impactful sectors.

→ SEBI regulations prescribe certain conditions and eligibility criteria for Category I AIFs, including investment concentration limits, diversification requirements, and reporting obligations.

→ These funds are required to comply with SEBI guidelines on disclosures, investor protection, valuation norms, and other regulatory requirements to maintain transparency and accountability.

B. Category II AIFs:

I. Explanation:

Category II AIFs encompass funds that invest in sectors other than those specified for Category I AIFs. These funds focus on a broader range of investment opportunities across various asset classes, including equity, debt, real estate, commodities, structured products, and other alternative assets.

II. Investment Strategies and Permissible Activities:

i. Category II AIFs adopt diverse investment strategies such as private equity, debt financing, distressed assets, real estate investments trusts (REITs), infrastructure investment trusts (InvITs), and other forms of alternative investments.

ii. Permissible activities include investments in listed and unlisted securities, derivatives, commodities, structured products, and other financial instruments, subject to regulatory restrictions and investment guidelines.

III. Regulatory Framework:

i. Category II AIFs are subject to a comprehensive regulatory framework established by SEBI, which includes registration requirements, compliance obligations, and reporting standards.

ii. SEBI regulations impose certain investment restrictions, risk management guidelines, and disclosure norms on Category II AIFs to protect investor interests, maintain market integrity, and ensure regulatory compliance.

iii. These funds are required to adhere to SEBI guidelines on asset allocation, leverage limits, valuation methodologies, conflict of interest management, and other regulatory requirements applicable to AIFs.

C. Category III AIFs:

I. Explanation:

Category III AIFs are funds that employ complex trading strategies and derivatives to generate high returns for investors. These funds typically target sophisticated investors with a high risk tolerance and seek to capitalize on market inefficiencies, arbitrage opportunities, and volatility across various asset classes.

II. Investment Strategies and Permissible Activities:

i. Category III AIFs adopt aggressive investment strategies such as hedge funds, high-frequency trading, algorithmic trading, derivative trading, and other sophisticated trading techniques.

ii. Permissible activities include investments in equity, derivatives, commodities, currencies, options, futures, swaps, and other financial instruments with the aim of maximizing returns through active trading strategies.

III. Regulatory Framework:

i. Category III AIFs are subject to stringent regulatory oversight by SEBI due to the inherent risks associated with their investment strategies and trading activities.

ii. SEBI regulations impose strict eligibility criteria, investment restrictions, leverage limits, risk management requirements, and disclosure norms on Category III AIFs to safeguard investor interests and maintain market stability.

iii. These funds are required to comply with SEBI guidelines on investor suitability, disclosure of trading strategies, valuation methodologies, risk measurement techniques, and other regulatory requirements applicable to AIFs.

5. DISCLOSURE STANDARDS FOR AIF

Alternative Investment Funds (AIFs) in India are subject to disclosure requirements mandated by the Securities and Exchange Board of India (SEBI) to ensure transparency and investor protection. Here's an overview of these disclosure standards, including the types of disclosures and the importance of transparency and investor communication:

I. Overview of Disclosure Requirements:

i. *Offer Document Disclosure:* AIFs are required to prepare and disclose an offer document to investors, providing comprehensive information about the fund's objectives, investment strategy, risk factors, fee structure, past performance (if any), and other relevant details. The offer document serves as a primary source of information for investors considering investment in the AIF.

ii. *Periodic Disclosures:* AIFs must make periodic disclosures to investors, including financial statements, NAV (Net Asset Value) calculation methodology, portfolio composition, changes in investment strategy or key personnel, and any material updates affecting the fund's operations or performance. These disclosures help investors monitor the fund's performance, track investment activities, and assess risks.

iii. *Event-Based Disclosures:* AIFs are required to promptly disclose certain events to investors that may have a material impact on the fund's operations or performance. This includes changes in key personnel, regulatory actions, significant investments or divestments, legal disputes, and any other developments that could affect investors' interests. Timely communication of such events enables investors to make informed decisions and manage risks effectively.

iv. *Regulatory Compliance Disclosures:* AIFs must comply with regulatory reporting requirements prescribed by SEBI, including filing of periodic reports, disclosures of related-party transactions, adherence to investment restrictions and concentration limits, and other compliance-related disclosures. This ensures regulatory oversight and transparency in fund operations, enhancing investor confidence and trust.

II. Types of Disclosures:

i. *Periodic Disclosures:* These include regular updates on the fund's financial performance, NAV, portfolio holdings, asset allocation, expense ratio, and other relevant information provided to investors at predetermined intervals (e.g., quarterly, semi-annually, annually).

ii. *Event-Based Disclosures:* These comprise disclosures of significant events or developments that occur during the life of the fund, such as changes in fund management, investment strategy, regulatory actions, material transactions, conflicts of interest, litigation, or other events that may impact investor interests.

iii. *Offer Document Disclosures:* These encompass disclosures made in the offer document provided to prospective investors during the fund's initial offering or subsequent fundraising rounds. Offer document disclosures include information on the fund's investment objectives, strategy, risks, fees, past performance (if available), terms and conditions, and other material facts relevant to investors' decision-making process.

III. Importance of Transparency and Investor Communication:

i. *Enhanced Investor Confidence*: Transparent disclosure practices foster trust and confidence among investors by providing them with access to timely and accurate information about the fund's operations, performance, and risks. This promotes investor loyalty and long-term commitment to the fund.

ii. *Informed Decision-Making*: Transparent disclosures enable investors to make informed investment decisions based on a comprehensive understanding of the fund's investment strategy, performance track record, risk profile, and other relevant factors. This helps investors align their investment objectives with the fund's objectives and risk tolerance.

iii. *Risk Management*: Effective disclosure practices facilitate risk identification, assessment, and mitigation by providing investors with insights into the fund's investment activities, portfolio composition, and exposure to various risks. This enables investors to evaluate risk-return trade-offs and diversify their investment portfolios accordingly.

iv. *Regulatory Compliance*: Transparent disclosure practices ensure compliance with regulatory requirements and standards prescribed by SEBI, promoting good governance, accountability, and integrity in fund operations. Compliance with disclosure obligations also helps mitigate legal and regulatory risks associated with non-compliance.

6. INVESTMENT IN AIF

Investing in Alternative Investment Funds (AIFs) in India is governed by specific guidelines regarding investor eligibility, minimum investment thresholds, and investor protection measures. Here's an overview of these aspects:

I. Guidelines on Who Can Invest in AIFs:

i. *Accredited Investors:* AIFs in India typically cater to accredited investors, including high net worth individuals (HNIs), institutional investors, family offices, and qualified foreign investors (QFIs). These investors are deemed to possess the necessary financial sophistication, risk appetite, and investment experience to participate in alternative investment opportunities.

ii. *Minimum Net Worth Requirement:* SEBI regulations prescribe minimum net worth criteria for individual and institutional investors to qualify for investment in AIFs. This requirement ensures that investors have sufficient financial resources to bear the risks associated with alternative investments and meet any minimum investment thresholds set by the AIF.

iii. *Qualified Institutional Buyers (QIBs):* Certain categories of AIFs may limit investment to QIBs, as defined under SEBI regulations, which include institutional investors such as mutual funds, insurance companies, pension funds, banks, and other specified entities. QIBs are deemed to possess the requisite financial expertise and regulatory oversight to participate in sophisticated investment strategies offered by AIFs.

II. Minimum Investment Thresholds and Eligibility Criteria for Investors:

i. *Minimum Investment Amount*: AIFs may impose minimum investment thresholds for investors to participate in the fund. These thresholds vary depending on the fund's investment strategy, target asset class, and regulatory requirements. Minimum investment amounts are typically set to ensure that investors commit sufficient capital to justify the costs and complexities associated with managing the fund.

ii. *Eligibility Criteria*: In addition to minimum investment thresholds, AIFs may impose eligibility criteria such as investor accreditation, minimum net worth requirements, professional qualifications, or industry-specific expertise. These criteria help ensure that investors possess the necessary financial resources, risk tolerance, and understanding of the fund's investment objectives and strategies.

III. Risks Associated with Investing in AIFs and Investor Protection Measures:

i. *Market Risk*: AIF investments are subject to market risks associated with fluctuations in asset prices, interest rates, exchange rates, and macroeconomic factors. Investors may experience losses or diminished returns due to adverse market conditions impacting the performance of underlying assets.

ii. *Liquidity Risk*: AIF investments may be illiquid, with limited opportunities for redemption or exit, especially in the case of private equity, real estate, and infrastructure funds. Investors should be aware of the potential challenges associated with liquidity risk and consider their investment horizon and liquidity needs accordingly.

iii. *Operational Risk*: AIFs are exposed to operational risks related to fund management, compliance, valuation, custody, and administration. Poor governance, inadequate risk management practices, or operational failures could adversely affect the fund's performance and investor returns.

iv. *Regulatory Risk*: Changes in regulatory policies, tax laws, or compliance requirements may impact the operating environment for AIFs and their investors. Regulatory uncertainty or non-compliance could result in legal, financial, or reputational consequences for the fund and its investors.

IV. Investor Protection Measures:

i. *Disclosure Requirements*: AIFs are required to provide comprehensive disclosures to investors regarding fund objectives, investment strategy, risks, fees, past performance, and regulatory compliance. Transparent and timely disclosures enable investors to make informed decisions and assess the suitability of the investment.

ii. *Due* Diligence Process: AIF managers conduct thorough due diligence on investment opportunities, assessing risks, returns, and alignment with fund objectives. Investors benefit from the manager's expertise and diligence in selecting and managing investments on their behalf.

iii. *Independent* Valuation: AIFs may engage independent third-party valuers to conduct periodic valuations of fund assets, ensuring transparency, fairness, and accuracy in asset pricing. Independent valuation helps mitigate conflicts of interest and provides assurance to investors regarding the fund's net asset value (NAV) calculation.

iv. *Regulatory* Oversight: SEBI regulates and supervises AIF activities to ensure compliance with regulatory requirements, protect investor interests, and maintain market integrity. SEBI's regulatory oversight includes registration, disclosure norms, compliance monitoring, and enforcement actions against non-compliant entities.

7. FOREIGN INVESTMENT IN AIF

A. Regulatory Framework:

I. Foreign Exchange Management Act (FEMA):

i. Foreign investment in AIFs falls under the purview of the Foreign Exchange Management Act (FEMA), which regulates cross-border transactions, capital inflows, and repatriation of funds.

ii. FEMA provisions govern foreign direct investment (FDI), foreign portfolio investment (FPI), and other forms of foreign investment in India, including investments in AIFs.

II. SEBI (Foreign Portfolio Investors) Regulations, 2019:

i. SEBI regulates foreign portfolio investment in Indian securities, including investments in AIFs, through the Foreign Portfolio Investors (FPIs) regime.

ii. FPIs are entities registered with SEBI that invest in Indian securities markets, including equity, debt, and other instruments such as AIF units.

III. SEBI (Alternative Investment Funds) Regulations, 2012:

i. SEBI regulations governing AIFs in India provide guidelines on foreign investment limits, eligibility criteria, compliance requirements, and reporting obligations for AIFs with foreign investments.

ii. AIFs are required to comply with SEBI regulations and circulars issued from time to time regarding foreign investment limits, sectoral caps, reporting formats, and other regulatory requirements.

B. Restrictions on Foreign Ownership and Participation:

i. *Foreign Investment Limits*: SEBI regulations prescribe limits on foreign investment in Indian AIFs, which may vary depending on the category of AIF and the nature of foreign investors (e.g., foreign institutional investors, non-resident Indians, overseas corporate bodies).

ii. *Sectoral Caps*: Certain sectors or industries may have specific foreign investment limits or sectoral caps imposed by regulatory authorities or government policies. AIFs investing in sectors subject to sectoral caps must comply with applicable restrictions on foreign ownership and participation.

iii. *Regulatory* Approvals: Foreign investors participating in Indian AIFs may be required to obtain regulatory approvals or licenses from SEBI, Reserve Bank of India (RBI), or other relevant authorities as per the applicable regulatory framework.

C. Compliance Requirements for AIFs with Foreign Investments:

i. *Reporting and Disclosures*: AIFs with foreign investments are required to make regular disclosures and reports to SEBI and other regulatory authorities as per the prescribed formats and timelines.

ii. *KYC and AML Compliance*: AIFs must adhere to know-your-customer (KYC) and anti-money laundering (AML) compliance requirements for foreign investors, including verification of identity, source of funds, and compliance with applicable AML/CFT (combating the financing of terrorism) regulations.

iii. *Tax Compliance*: AIFs with foreign investments must comply with tax laws and regulations applicable to foreign investors, including withholding tax requirements, transfer pricing regulations, and other tax compliance obligations.

iv. *Regulatory Filings*: AIFs are required to submit periodic filings, returns, and disclosures to SEBI, RBI, and other regulatory authorities as per the regulatory framework governing foreign investment in India.

8. INVESTMENT BY AIF

I. Parameters for Investment by AIFs in Various Asset Classes:

i. *Equity Securities*: AIFs may invest in equity securities of listed companies, unlisted companies, startups, and other eligible entities. Investments in equity securities are subject to diversification requirements, concentration limits, and regulatory restrictions prescribed by SEBI.

ii. *Debt Instruments*: AIFs can invest in debt instruments such as corporate bonds, government securities, debentures, non-convertible securities, and other fixed-income securities. Investments in debt instruments may be subject to credit quality assessment, maturity profile, interest rate risk, and liquidity considerations.

iii. *Real Estate*: AIFs may invest in real estate assets, including commercial properties, residential projects, retail spaces, hospitality assets, and industrial properties. Real estate investments entail considerations such as location analysis, market dynamics, rental yields, capital appreciation potential, regulatory approvals, and exit strategies.

iv. *Infrastructure*: AIFs have the option to invest in infrastructure projects, including roads, bridges, ports, airports, power plants, telecommunications networks, and other infrastructure assets. Infrastructure investments require thorough due diligence, project feasibility analysis, regulatory compliance, and risk assessment.

v. *Venture Capital and Private Equity:* AIFs may engage in venture capital financing, private equity investments, and growth capital funding for startups, early-stage ventures, and emerging companies. Investments in venture capital and private equity involve evaluation of business models, market potential, management team, scalability, exit opportunities, and regulatory compliance.

II. Risk Management Practices and Investment Guidelines:

i. *Risk Identification and Assessment*: AIFs employ robust risk management practices to identify, assess, and mitigate various types of risks associated with investment activities. Risk factors considered include market risk, credit risk, liquidity risk, operational risk, regulatory risk, and geopolitical risk.

ii. *Diversification Strategies*: AIFs diversify their investment portfolios across multiple asset classes, sectors, geographies, and investment strategies to reduce concentration risk and enhance risk-adjusted returns. Diversification helps spread investment risk and mitigate the impact of adverse events on portfolio performance.

iii. *Due Diligence Process*: AIFs conduct comprehensive due diligence on potential investment opportunities, including financial analysis, legal due diligence, technical assessment, market research, and regulatory compliance review. Due diligence helps assess the quality of investments, identify potential risks, and make informed investment decisions.

iv. *Portfolio Monitoring and Risk Mitigation*: AIFs continuously monitor portfolio investments, track performance metrics, and implement risk mitigation strategies to address emerging risks, market fluctuations, and other adverse developments. Active portfolio management aims to optimize risk-adjusted returns and preserve capital.

III. Role of Investment Managers and Advisors in Decision-Making:

i. *Investment Strategy Formulation*: Investment managers and advisors play a key role in formulating the investment strategy, asset allocation decisions, and portfolio construction process for AIFs. They assess market conditions, macroeconomic factors, industry trends, and investor objectives to develop tailored investment strategies.

ii. *Deal Sourcing and Evaluation*: Investment managers and advisors are responsible for sourcing investment opportunities, conducting preliminary screenings, and evaluating potential deals based on predefined investment criteria. They assess the feasibility, attractiveness, and risk-return profile of investment opportunities before presenting them to the investment committee for approval.

iii. *Execution and Monitoring*: Investment managers and advisors oversee the execution of investment transactions, negotiate terms and conditions, and coordinate the due diligence process. They monitor portfolio investments, track performance metrics, and provide regular updates to investors on investment activities, portfolio performance, and risk exposures.

iv. *Compliance and Reporting*: Investment managers and advisors ensure compliance with regulatory requirements, investment guidelines, and reporting obligations prescribed by SEBI and other regulatory authorities. They maintain accurate records, prepare periodic reports, and facilitate investor communication to enhance transparency and accountability in the investment process.

9. OVERSEAS INVESTMENT BY AIF

I. Provisions for AIFs to Make Investments Outside India:

i. *Regulatory Framework*: AIFs in India are governed by the Securities and Exchange Board of India (SEBI) regulations, which provide guidelines for making investments outside India. SEBI permits AIFs to invest a portion of their funds in overseas assets as part of their investment strategy.

ii. *Eligible Jurisdictions*: AIFs may invest in eligible jurisdictions outside India, subject to regulatory restrictions, foreign exchange regulations, tax implications, and other legal considerations. Eligible jurisdictions may include developed markets, emerging economies, and specific countries identified by SEBI.

iii. *Investment Mandate*: AIFs must define their investment mandate and objectives regarding overseas investments in their offering documents or scheme documents. The investment mandate outlines the permissible asset classes, sectors, geographies, and risk parameters for overseas investments.

II. Regulatory Approvals and Compliance Requirements for Overseas Investments:

i. *Foreign Exchange Regulations*: AIFs must comply with foreign exchange regulations prescribed by the Reserve Bank of India (RBI) for remittance of funds abroad, repatriation of returns, and compliance with foreign exchange management norms. RBI regulations govern cross-border transactions, capital flows, and foreign currency conversions.

ii. *SEBI Reporting Requirements*: AIFs are required to seek prior approval from SEBI for making investments outside India, as per the SEBI (Alternative Investment Funds) Regulations, 2012. AIFs must submit necessary documentation, disclosures, and compliance reports to SEBI regarding their overseas investment activities.

iii. *Tax Implications*: AIFs must consider tax implications associated with overseas investments, including withholding taxes, capital gains taxes, transfer pricing regulations, double taxation treaties, and other tax compliance requirements in both India and the host country where the investment is made.

iv. *Compliance with Foreign Laws*: AIFs must comply with applicable foreign laws, regulations, and legal requirements governing investments in the host country. This includes compliance with securities regulations, corporate governance norms, regulatory filings, and reporting obligations prescribed by regulatory authorities in the host jurisdiction.

III. Risks and Challenges Associated with Cross-Border Investments:

i. *Foreign Exchange Risk*: Overseas investments expose AIFs to foreign exchange risk arising from fluctuations in exchange rates between the Indian rupee and the currency of the host country. Exchange rate volatility can impact the valuation of overseas assets, repatriation of funds, and overall returns on investment.

ii. *Regulatory Risks*: AIFs face regulatory risks associated with compliance with foreign laws, regulations, and regulatory requirements in the host country. Differences in regulatory frameworks, legal systems, taxation policies, and investor protection standards may pose challenges for AIFs operating in overseas markets.

iii. *Political and Geopolitical Risks*: Overseas investments are subject to political and geopolitical risks arising from changes in government policies, regulatory frameworks, trade relations, diplomatic tensions, economic sanctions, and geopolitical conflicts in the host country.

iv. *Market Risks*: AIFs may encounter market risks such as market volatility, liquidity constraints, asset price fluctuations, and economic downturns in overseas markets. Differences in market dynamics, investor sentiment, and business cycles may impact the performance of overseas investments.

v. *Operational Risks*: Cross-border investments involve operational risks related to currency conversions, settlement processes, custody arrangements, taxation, legal documentation, and cross-border transactions. AIFs must establish robust operational processes, risk management systems, and compliance controls to mitigate operational risks associated with overseas investments.

10. FUNCTIONING OF AIF

I. Operational Structure and Governance Framework:

i. *Legal Structure:* AIFs in India are typically set up as trust structures, limited liability partnerships (LLPs), or corporate entities such as companies. The choice of legal structure depends on factors such as regulatory requirements, tax considerations, investor preferences, and operational flexibility.

ii. *Constitution of AIF:* AIFs are constituted with the appointment of trustees, investment managers, custodians, and other key service providers. The AIF's offering documents, such as the placement memorandum or scheme information document, outline the fund's objectives, investment strategy, terms and conditions, governance structure, and roles and responsibilities of key stakeholders.

iii. *Regulatory Compliance:* AIFs must comply with SEBI regulations, guidelines, and circulars applicable to AIFs, including registration requirements, disclosure norms, investment restrictions, asset valuation norms, risk management guidelines, and reporting obligations.

II. Roles and Responsibilities of Key Stakeholders:

i. *Trustees*: Trustees are responsible for safeguarding the interests of AIF investors and ensuring compliance with regulatory requirements. Their duties include overseeing the operations of the AIF, monitoring the actions of the investment manager, custodian, and other service providers, and ensuring adherence to the fund's investment mandate and governing documents.

ii. *Investment Managers*: Investment managers are appointed to manage the investment portfolio of the AIF in accordance with the fund's investment strategy, objectives, and risk parameters. Their responsibilities include identifying investment opportunities, conducting due diligence, executing investment transactions, monitoring portfolio performance, and managing investment risks.

iii. *Custodians*: Custodians are appointed to safe keep the assets of the AIF, maintain custody of securities, monitor corporate actions, reconcile portfolio holdings, and provide asset servicing functions. Custodians play a crucial role in ensuring the integrity, safety, and transparency of the AIF's assets and transactions.

iv. *Auditors*: Auditors are responsible for conducting financial audits, reviewing internal controls, assessing compliance with regulatory requirements, and providing assurance on the accuracy and integrity of the AIF's financial statements. Auditors play a vital role in enhancing transparency, accountability, and investor confidence in the AIF's operations.

III. Fund Administration, Accounting, and Reporting Standards:

i. *Fund Administration*: AIFs typically engage third-party fund administrators to perform fund accounting, administration, investor servicing, and regulatory compliance functions. Fund administrators handle tasks such as NAV calculation, investor onboarding, subscription and redemption processing, financial reporting, and regulatory filings.

ii. *Accounting Standards*: AIFs must adhere to accounting standards prescribed by SEBI, the Institute of Chartered Accountants of India (ICAI), and other regulatory authorities. Accounting standards govern the recognition, measurement, presentation, and disclosure of financial transactions and events in the AIF's financial statements.

iii. *Reporting Standards*: AIFs are required to prepare periodic reports, financial statements, and disclosures for investors, regulators, and other stakeholders as per SEBI regulations. Reporting standards include formats, templates, and timelines prescribed by SEBI for submission of financial reports, NAV disclosures, investor communications, and regulatory filings

11. OTHER IMPORTANT DETAILS

I. Tax Implications for AIFs and Investors

i. *Taxation of AIFs*: Alternative Investment Funds (AIFs) in India are subject to taxation on their income, including capital gains, interest income, dividend income, and other revenue streams. The tax treatment of AIFs may vary based on their legal structure (trust, LLP, company), investment strategy, and tax residency status.

ii. *Pass-through Status*: Certain categories of AIFs, such as Category I and Category II AIFs, enjoy pass-through status for tax purposes, wherein income earned by the AIF is taxed in the hands of investors rather than at the fund level. This pass-through treatment provides tax efficiency for investors and encourages investment in AIFs.

iii. *Tax Deduction at Source (TDS)*: AIFs may be required to deduct tax at source on certain payments made to investors, such as interest income, dividend income, and capital gains distributions, as per the provisions of the Income Tax Act, 1961. TDS rates and compliance requirements vary based on the nature of payments and investor categories.

iv. *Taxation of Investors*: Investors in AIFs are liable to pay taxes on their share of income distributed by the AIF, including capital gains, dividends, interest, and other distributions. The tax treatment of AIF income for investors depends on factors such as their residential status, investment horizon, and applicable tax rates.

II. Recent Regulatory Developments and Updates in the AIF Space

i. *Amendments to SEBI Regulations*: SEBI periodically reviews and updates the regulatory framework for AIFs in India to enhance investor protection, promote market integrity, and streamline regulatory compliance. Recent regulatory developments include amendments to SEBI (Alternative Investment Funds) Regulations, 2012, and issuance of circulars, guidelines, and notifications impacting AIF operations.

ii. *Introduction of New AIF Categories*: SEBI may introduce new categories of AIFs or modify existing categories to accommodate evolving market dynamics, investor preferences, and regulatory priorities. Recent developments may include the introduction of specialized AIF categories, such as social venture funds, distressed asset funds, or sector-specific funds.

iii. *Enhanced Reporting and Disclosure Requirements*: SEBI may enhance reporting and disclosure requirements for AIFs to improve transparency, governance, and investor communication. Recent developments may include additional disclosures on portfolio holdings, risk exposures, performance metrics, and compliance status required by AIFs.

III. Emerging Trends and Future Outlook for AIFs in India

i. *Rise of Sector-Specific Funds*: A growing trend in the AIF space is the emergence of sector-specific funds targeting niche sectors such as technology, healthcare, renewable energy, e-commerce, and infrastructure. Sector-specific funds cater to investor demand for specialized exposure and thematic investments in high-growth sectors.

ii. *Focus* on ESG Investing: AIFs are increasingly integrating environmental, social, and governance (ESG) factors into their investment decision-making processes to align with sustainable investing principles, responsible investment practices, and stakeholder expectations. ESG-focused AIFs aim to generate financial returns while creating positive social and environmental impact.

iii. *Expansion* of Venture Capital and Startup Ecosystem: The venture capital and startup ecosystem in India continues to attract significant interest from AIFs, both domestic and foreign. AIFs play a crucial role in providing growth capital, venture funding, and strategic support to startups and early-stage ventures across various sectors, driving innovation, entrepreneurship, and economic growth.

iv. *Cross*-Border Investments and Global Integration: AIFs in India are exploring opportunities for cross-border investments, strategic partnerships, and global integration to access international markets, diversify portfolios, and leverage global best practices. Cross-border collaborations enhance the competitiveness, scalability, and resilience of AIFs in an increasingly interconnected world.

What support do we offer?

→ Assist clients in structuring and forming AIFs by providing guidance on selecting the appropriate legal structure and drafting necessary offering documents in compliance with SEBI regulations.

→ Ensure regulatory compliance by guiding clients through SEBI regulations governing AIF registration and ongoing operations, ensuring adherence to disclosure norms, investment restrictions, and reporting obligations.

→ Tax advisory services to AIFs and investors, offering guidance on tax planning, structuring, and compliance to optimize tax efficiency and manage tax risks effectively.

→ Conduct financial audits, reviews, and assurance engagements for AIFs, verifying compliance with accounting standards, regulatory requirements, and valuation methodologies.

→ Assist in developing robust risk management frameworks and policies for AIFs, addressing market risk, credit risk, liquidity risk, operational risk, and regulatory risk.

→ Transaction advisory services for AIFs, supporting clients in identifying investment opportunities, conducting due diligence, structuring deals, and executing investment transactions.

→ Manage investor relations, communications, and reporting requirements for AIFs, ensuring compliance with investor protection norms, transparency standards, and disclosure obligations.

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