

Fund Governance- Governance in AIFs

Chirag Agarwal | Management Trainee | Vinod Kothari and Company

Kolkata:

1006-1009, Krishna Building
224 AJC Bose Road

Kolkata- 700 017

Phone: 033 2281 3742

Email: info@vinodkothari.com

New Delhi:

Nukleus, 501 & 501A, Salcon
Rasvilas, District Centre, Saket

New Delhi -110017

Phone: 011 41315340

Email: delhi@vinodkothari.com

Mumbai:

403-406, Shreyas Chambers
175, D N Road, Fort

Mumbai- 400001

Phone: 022 2261 4021/ 6237 0959

Email: bombay@vinodkothari.com

Bengaluru:

4, Union Street, Infantry
Road, Shivaji Nagar,

Bengaluru- 560001

Phone: 022 2261 4021/ 6237 0959

Email: info@vinodkothari.com

AGENDA

- Understanding Alternative Investment Funds (AIFs)
- Why is Corporate Governance needed in AIFs?
- Regulatory Framework- Corporate Governance
 - Valuation
 - Reporting Requirement

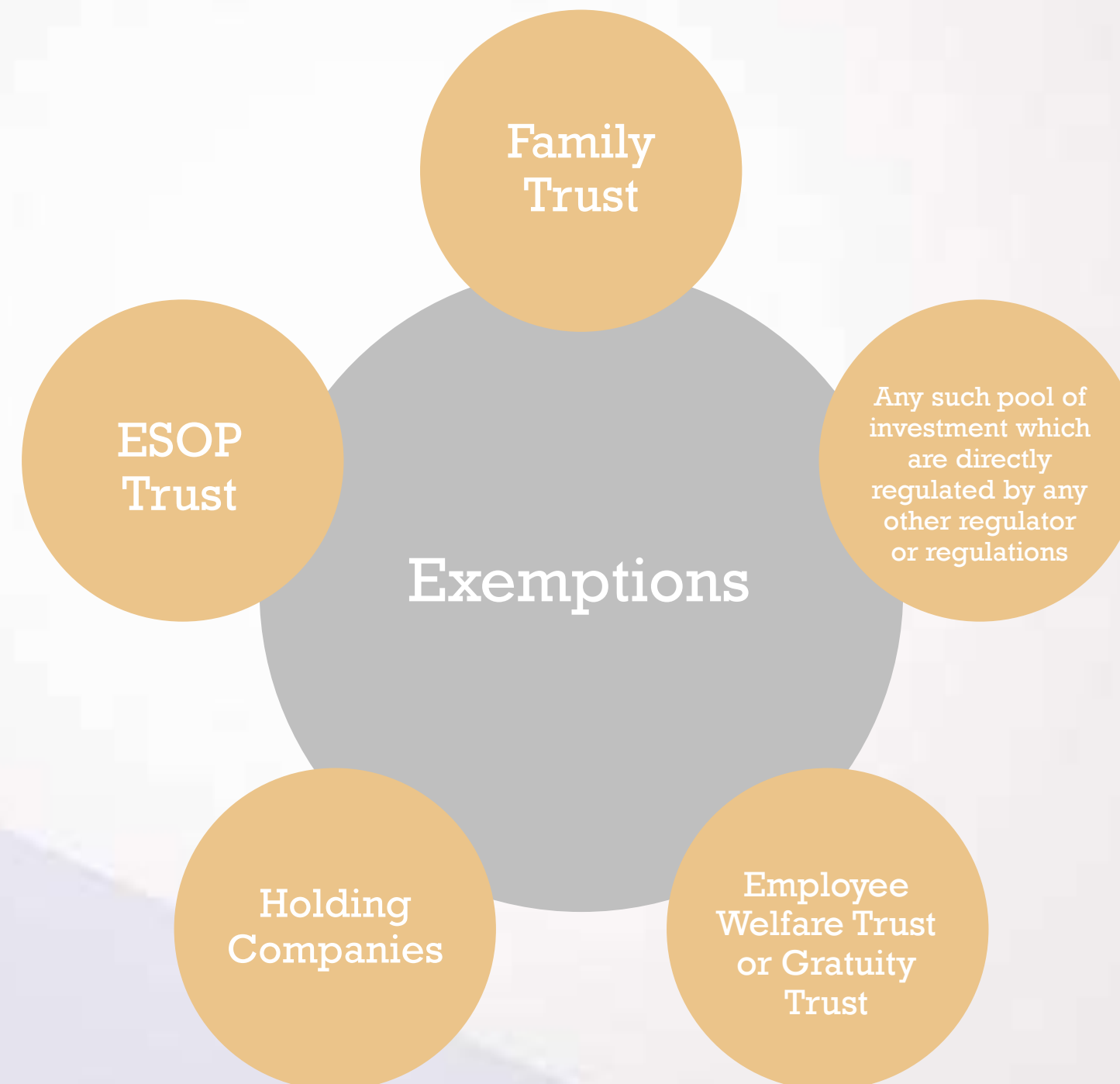
Understanding Alternative Investment Fund(AIF)

What is an AIF?

- AIFs are privately pooled investment vehicle
- Set up in the form of Trust or Company or Limited Liability Partnership or Body Corporate
- Which collects funds from investors and invest it in accordance with a defined investment objective
- AIFs provides unique set of attributes that are not generally found in traditional mode of investments which include following characteristics:
 - Long Term
 - High Risk
 - Higher returns

What is not an AIF?

The following are not considered as AIFs:



Categories of AIFs

AIFs

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graph TD; AIFs[AIFs] --> CategoryI[Category I]; AIFs --> CategoryII[Category II]; AIFs --> CategoryIII[Category III];
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Category I

Category II

Category III

Category I AIF

- AIFs which invest in early stage ventures or startup or social ventures.
- They invest in areas which the government or regulators consider as economically and socially desirable.
- They are generally perceived to have a positive spillover effect on the economy for which Board or Government might consider providing incentive or concessions.
- Category I AIFs are not allowed to borrow funds except for meeting temporary day-to-day requirements.
- Maximum investment per investee company is 25% of investable funds.



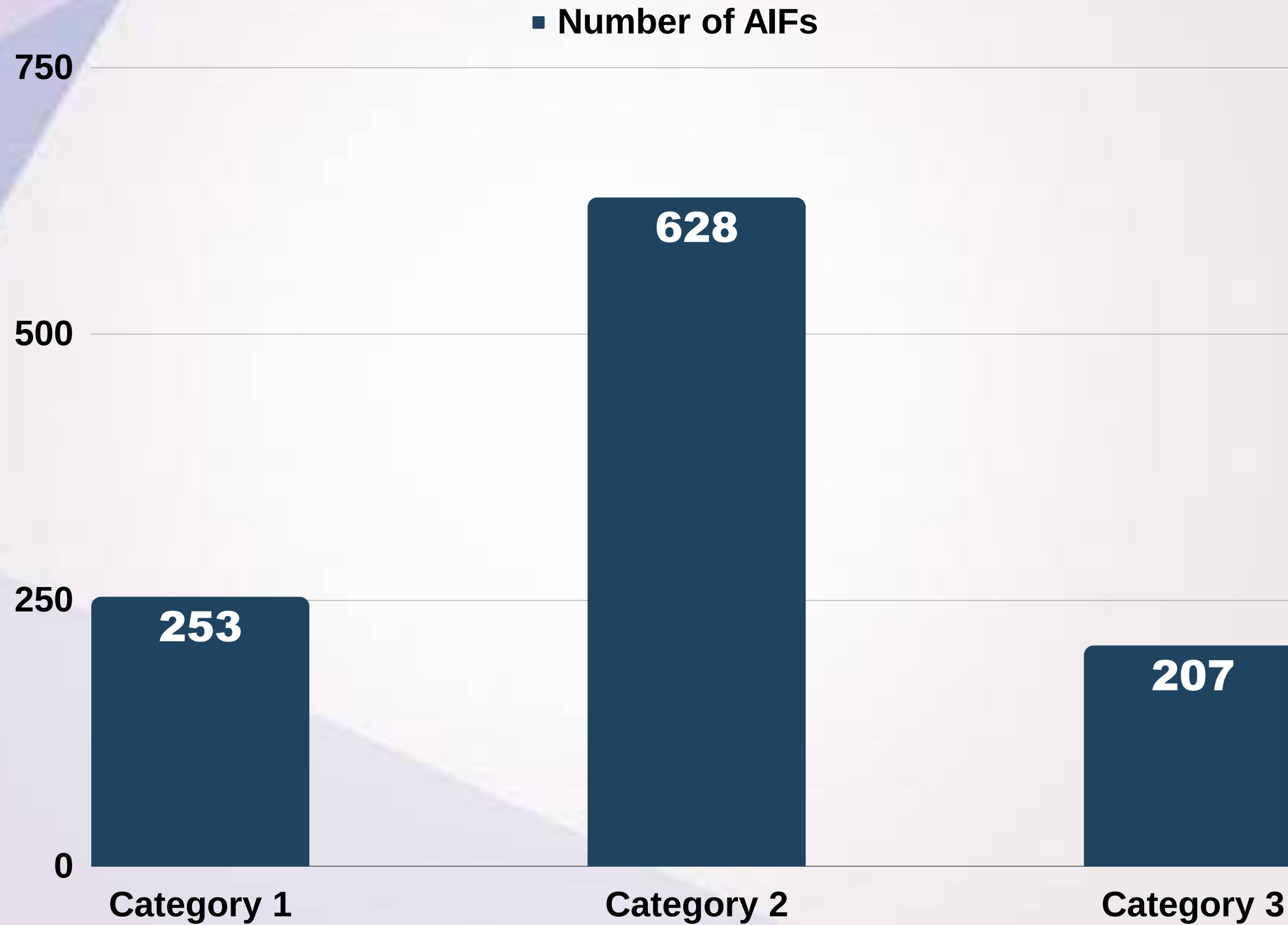
Category II AIF

- AIFs which do not fall in Category I and Category III AIF.
- Category II AIFs are not allowed to borrow funds except for meeting temporary day-to-day requirements.
- AIFs such as Private Equity Fund or Debt Fund are included.
- Maximum investment per investee company is 25% of investable funds.

Category III AIF

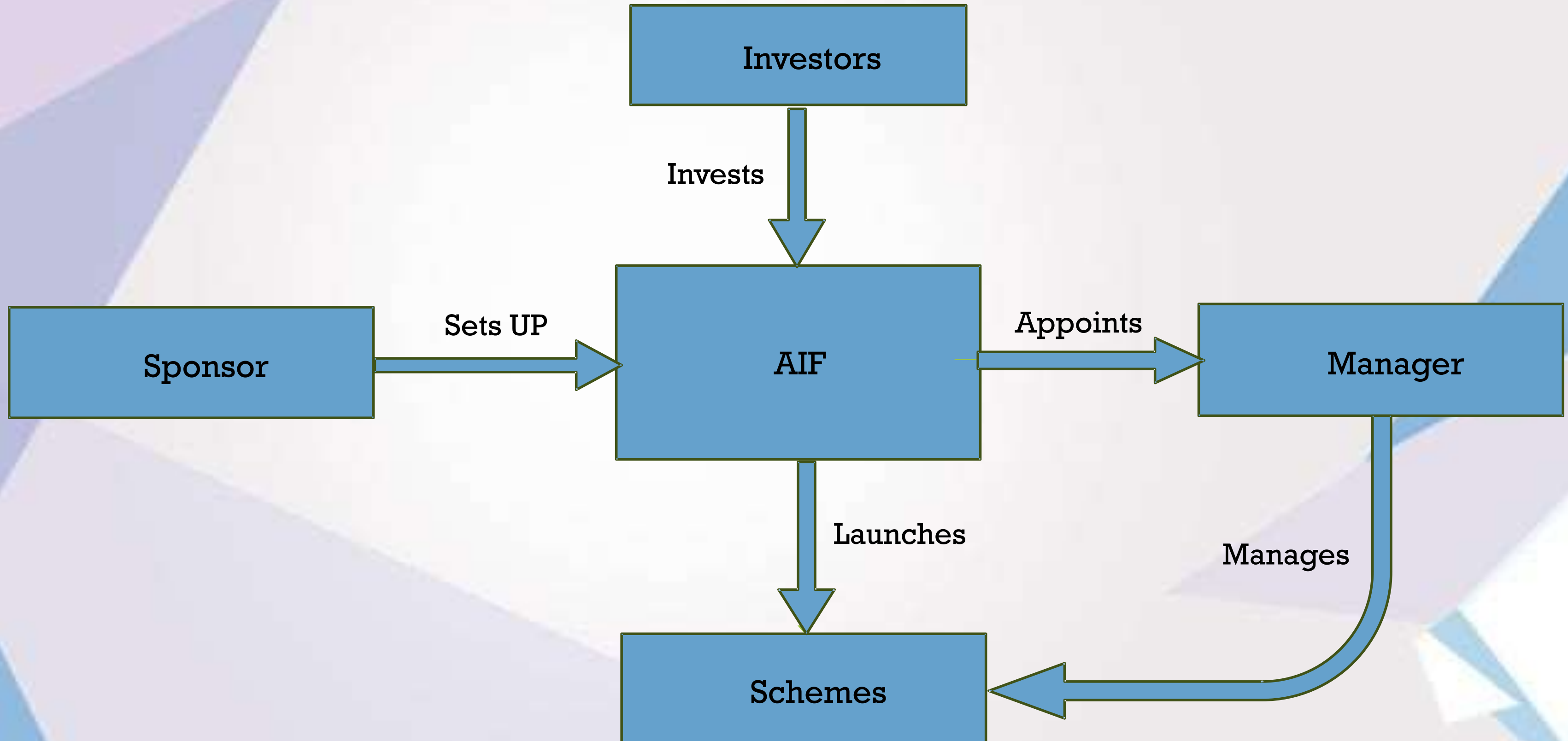
- Invest in securities of listed or unlisted investee companies or derivatives or complex structured products..
- Can be either open ended or close ended.
- No specific incentives or concessions are given by government or any other regulator.
- These category of funds can employ leverage unlike Category I and II AIFs.

Statistics of AIFs Registered in India



Data as on 31.03.2023

Structure of AIF



Regulatory Overview

- SEBI framed the SEBI (Venture Capital Funds) Regulations, 1996 encouraging investments in start-ups and mid-size companies
- Private equity funds, real estate funds and many other funds started using VCF route as registration was not mandatory and were not subject to investment restriction.
- SEBI noted the need for comprehensive regulations to deal with investments that are sourced from diverse parts of the private pool of capital.
- Accordingly, SEBI notified the Alternative Investment Fund (AIF) Regulations - on 21 May, 2012 to govern unregulated entities and create a level playing ground for existing venture capital investors.



Why is Corporate Governance needed in AIFs?

To fully realize the objective of ease of monitoring and administration by stakeholders and enhancing transparency.

Safekeeping of the securities

Independent monitoring of investments of AIFs

Supervision of inactive AIFs

Keeping a check on unauthorized fund raising

Maintaining pro-rata rights of investors in each investment of the scheme of the AIF, including while making distribution of investment proceeds

Corporate Governance

- Sponsor is required to contribute sponsor commitment to AIF to ensure that there is skin in the game.
- SEBI has recently standardized the valuation norms in case of AIFs which would enable the investors to easily familiarize themselves with the valuation methodologies.
- There should be proper segregation of bank accounts and securities account. The segregation should be scheme-wise.
- Category I and Category II AIFs are also required to annually provide investors with the financial details of its portfolio companies and information pertaining to any material risks. In case of Category III AIFs, such reports are to be provided to the investors on a quarterly basis.



- For a Category I or Category II AIF, the sponsor or the manager should have a continuing interest of 2.5% of the corpus of the fund or Rs 5 crore, whichever is lower.
- In case of a Category III AIF, a continuing interest of 5% of the corpus or Rs 10 crore, whichever is lower.
- AIFs shall not invest in associates or units of AIF managed by its sponsor or manager except with the approval of 75% of investors.
- The Investment Manager(IM) is required to submit Compliance Test Report(CTR) to the Sponsor providing a list of compliances/non-compliances with the AIF Regulations.



Stewardship Code for AIFs

Institutional Investors should formulate a comprehensive policy on the discharge of their stewardship responsibilities, publicly disclose it, review and update it periodically.

Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.

Institutional investors should monitor their investee companies.

Institutional investors should have a clear policy on intervention in their investee companies. Institutional investors should also have a clear policy for collaboration with other institutional investors where required, to preserve the interests of the ultimate investors, which should be disclosed.

Institutional investors should have a clear policy on voting and disclosure of voting activity

Institutional investors should report periodically on their stewardship activities.

Valuation

The valuation of investments of AIFs are to be carried out as per-



SEBI(Mutual Fund) Regulations, 1996 for securities whose valuation norm have been prescribed in Mutual Fund regulations

Valuation guidelines endorsed by any AIF industry association for other securities.

Valuation of Traded and Non Traded Securities

Traded Securities – Valuation as per last quoted closing price on stock exchange

Non Traded Securities – To be valued by Asset Management Company(AMC) based on principles approved by Board of the AMC

Valuation of Convertible Securities

Non Convertible portion - would be valued on the same basis as applicable to debt instruments

Convertible portion - valuation would be done in the way equity instruments are valued

Valuation of Rights Shares

Until rights shares are traded they should be valued as no. of rights offered divided by the no. of original shares held multiplied by the difference between Ex rights price and rights offer price.

Valuation of Other Securities

Valuation shall be carried out as per the valuation guidelines approved by AIF Industry Association.

Eligibility of Independent Valuer

- Not be as associate or manager or sponsor or trustee of AIF
- Hold membership as a CA, CS, CMA, or CFA
- Have an experience of at least 3 years
- If valuer is a company it should be a holding or a subsidiary of a credit rating agency registered with SEBI

Reporting Requirements

- All AIFs shall submit quarterly report of their activities to SEBI.
- Category III AIF shall submit report on leverage taken on quarterly basis to SEBI.
- Any changes made to the Private Placement Memorandum within a month from the end of each Financial year.
- The AIFs shall provide to investors its valuation procedure and methodology.
- Category I and II AIFs shall undertake valuation semi annually.
- AIFs shall disclose to investors any inquiries/legal actions.
- AIF shall disclose to investors change in control of Sponsor/Manager/Investee Company.



Placement memorandum

The Placement Memorandum shall contain following information-

- Material Information about the AIF and the Manager
- Background of key investment team of Manager
- Targeted investors
- Fees and other expenses proposed to be charged
- Tenure of AIF
- Investment strategy
- Risk Management tools
- Conflict of Interest, if any





Thank you