

Indian Association of Alternative Investment Funds (IAAIF)



Alternative Investment Funds

Marketing, Fund raising & Investor Relations

Segmenting AIFs

Understanding AIFs – Benchmarking to closest peer: Mutual Funds

Risk-Return Framework : Where do AIFs stand

Key Regulatory Considerations in Marketing

Investor Landscape in AIFs

AIF: Industry Best Practices

Investors: Things to keep in mind

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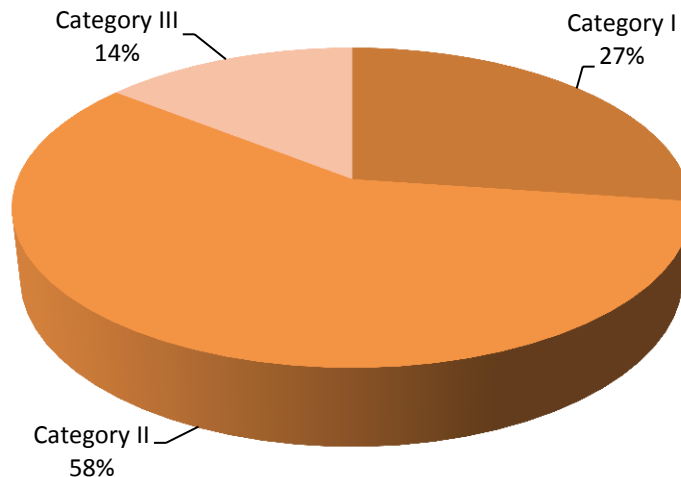
Investors: Things to keep in mind

AIF Industry - Overview



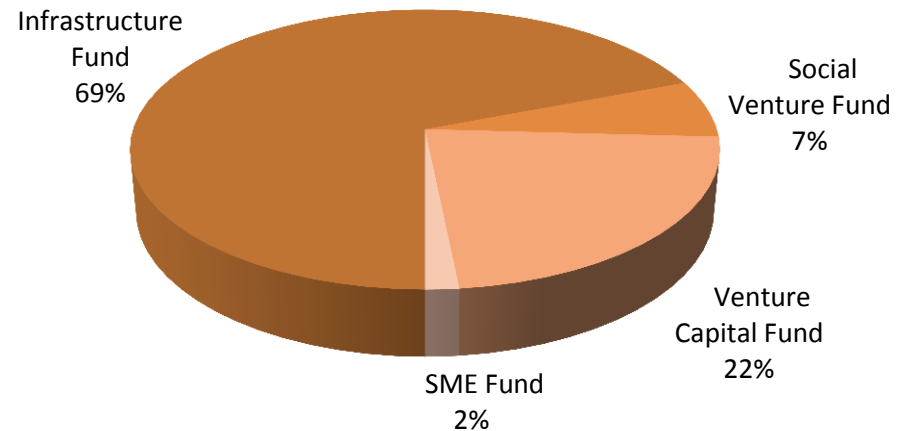
- Total commitments raised by AIFs Industry is INR 702 billion as of December 2016
- Of the total commitments raised, Category II AIFs contribute to the largest share at 58% followed by Category I AIFs at 27%.
- Majority of funds are in the form on Infrastructure and Venture Capital Funds

Category-wise share



Source: SEBI, Based on capital commitments

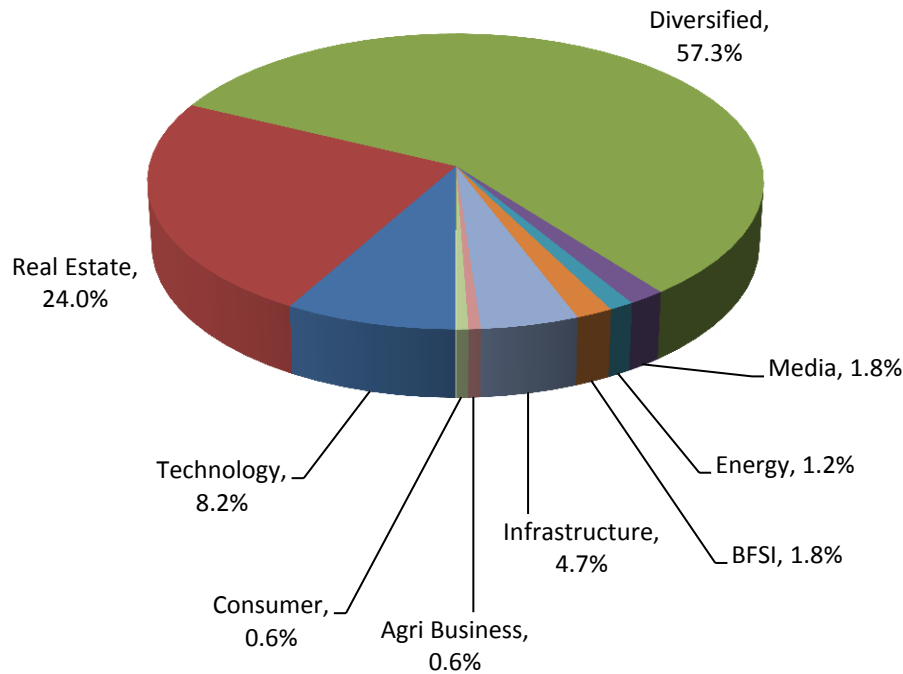
Category I AIFs



Source: SEBI, Based on capital commitments

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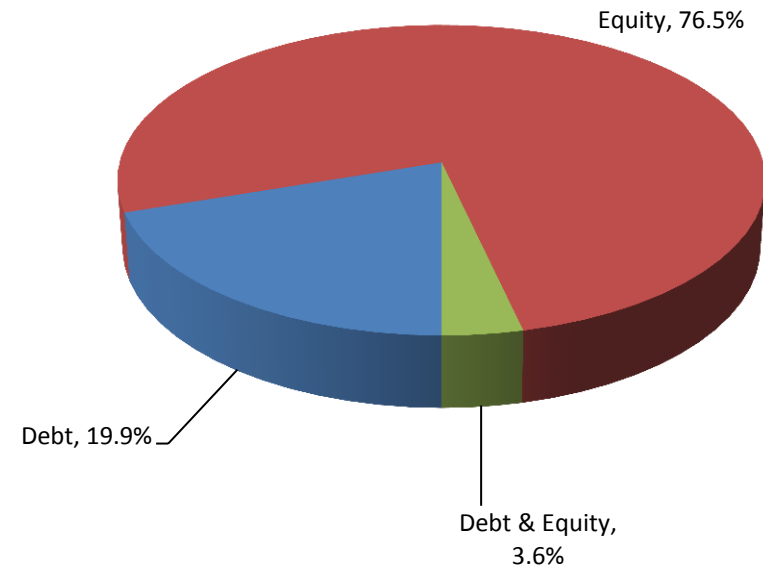
Sector



Source: Primary research

- Most funds have a diversified focus .
- Real estate emerges is a prominent industry for AIFs which have single-sector investment strategy

Focus



Source: Primary research

- Most funds are equity funds
- Among the debt funds, a large part of the AIFs are real estate based AIFs

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Comparison with Mutual Funds



| | Alternative Investment Fund (AIF) | Mutual Fund (MF) |
|--|---|---|
| Legal Structure | An AIF can be a Trust/Company/Limited Liability Partnership/Body Corporate which is established/incorporated in India. | A MF is set up as a trust, which has sponsor, trustees, asset management company (AMC), and custodian. |
| Manager/ Sponsor | Manager and sponsor can be the same | Sponsor is different from manager. Sponsor has to contribute not less than 40% to the net worth of the AMC. |
| Fund Types | Category I and II AIFs should be Closed Ended; Category III AIF can be both Closed Ended and Open Ended | A Mutual Fund can be both Closed Ended or Open Ended funds. |
| Minimum Corpus | An AIF should have a minimum corpus of Rs 20 crores. | The minimum subscription amount of debt oriented and balanced schemes at the time of new fund offer shall be at least Rs 20 crores and that of other schemes shall be at least Rs 10 crores. An average AUM of Rs 20 crore on half yearly rolling basis shall be maintained for open ended debt oriented schemes. |
| Minimum Investment by Investors | Minimum investment size for an AIF is Rs 1 crore. However, if investors are employees/directors of the AIF or employees/directors of the Manager, then minimum investment value is reduced to Rs 25 lakh. | Depending on the mutual fund scheme, AMC will mention in offer document the minimum investment amount. |

Comparison with Mutual Funds



| | Alternative Investment Fund (AIF) | Mutual Fund (MF) |
|----------------------------|---|--|
| Continuing Interest | Manager/Sponsor shall have a continuing interest of not less than 2.5% of the corpus or Rs 5 crore (5% of corpus or Rs 10 crore in case of category III AIF), whichever is lower. | Sponsor or Asset Management Company shall invest not less than 1.0% of the corpus or Rs 50 lakhs, whichever is less, in the growth option of each scheme |
| Issuance of Units | AIFs can issue units only through private placements | MFs can issue units by way of public issuance |
| Listing in Exchange | Listing is permitted but there is no compulsion for AIFs to list units on an exchange. | Every closed ended scheme, other than an equity linked savings scheme, has to be listed on a recognized stock exchange. |
| Min. Tenure | No scheme of an AIF can have a tenure shorter than 3 years. | No minimum tenure |
| Number of Investors | An AIF cannot have more than 1000 investors in any scheme. | There is no such ceiling in case of mutual funds. |
| Tax Treatment | Cat I & II AIFs have pass through status. 10% withholding tax is deducted on the PAN of investor | Indexation and other benefits available, depending on scheme and tenor |

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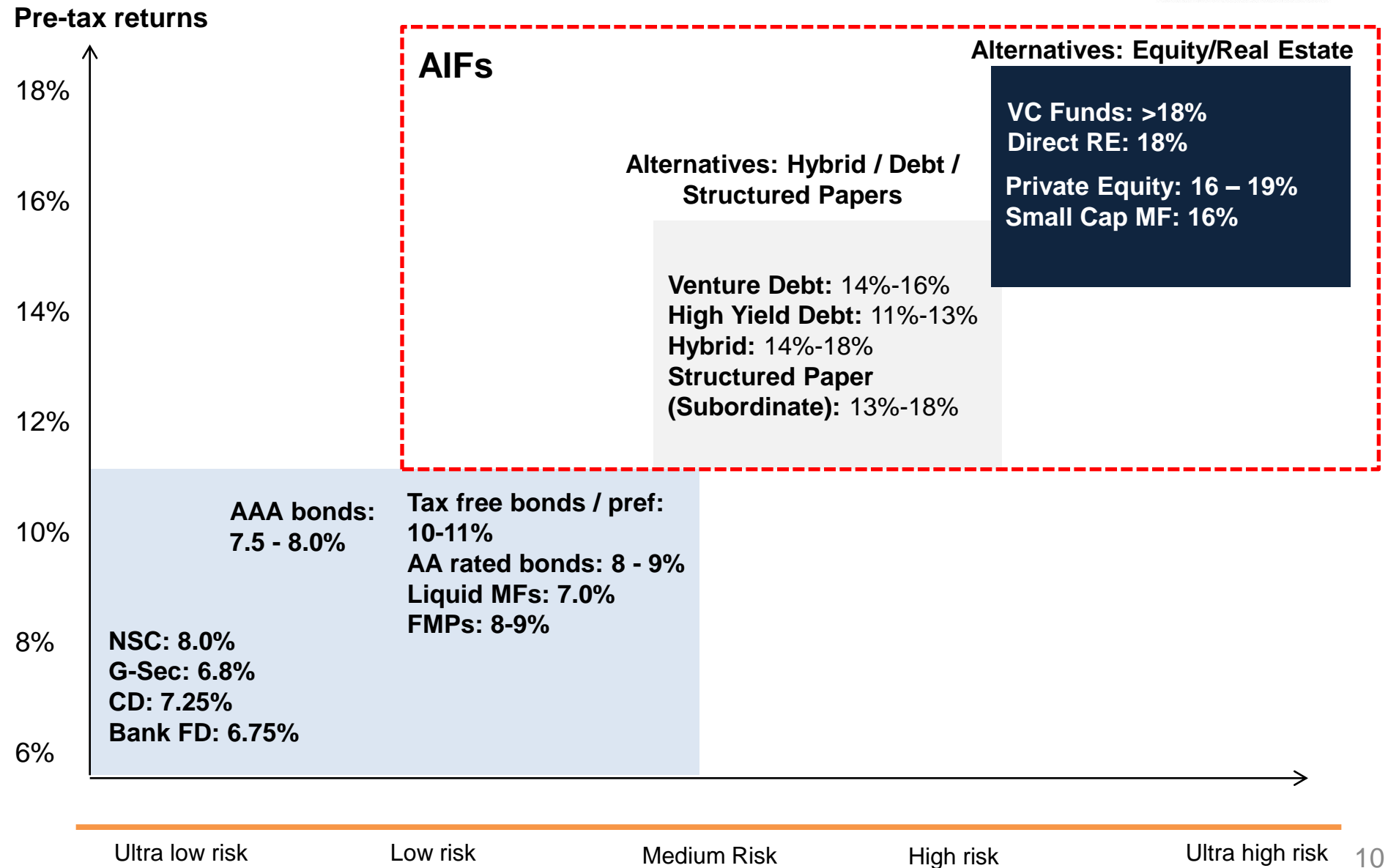
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AIFs: Risk-Return Continuum



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Private Placement

Minimum Commitment Size

Disclosures for Conflict of Interest

Taxation

Foreign Investments

- ✓ **Private Placement** – AIF Units can only be placed through a private placement
- ✓ **No. of Investors** – No AIF Scheme can have more than 1000 investors
- ✓ **Minimum Commitment** – Minimum Commitment from investors is INR 1 crores (INR 25 lakhs in case of employees of Sponsor/Manager)
- ✓ **Conflict of interest** – All such situations must be avoided and in case unavoidable, adequate disclosures must be made for the same
- ✓ **Taxation** – Cat I and II AIFs are tax pass through vehicles. The AIFs do not pay any tax and also do not suffer any Tax Deducted at Source (TDS) for interest payments.
 - 10% withholding is done while making distributions
 - For offshore investors, the rate of withholding to be determined based on DTAA
- ✓ **Foreign Investments** - AIFs have been permitted by both SEBI and RBI for accepting foreign investments

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Investor Landscape and considerations

Bank Treasuries:

- Medium to long term duration with no liquidity is a concern
- Risk weight could be penal
- Modification of policy
- Taxation – less attractive than Mutual Funds due to indexation benefit
- Core part of large treasuries take exposure in alternatives for yield kicker and diversification

Pension Funds:

- Private sector NPS permitted to invest in AIFs of upto 5%
- Given long term nature of AIFs, fits into long term investment philosophy of pension funds
- Offers diversification away from ultra-safe long term assets



NBFCs:

- In sluggish loan growth environment, attractive addition to grow investment book
- Managed product, so no-hassle investment with minimal diligence and monitoring
- Building underwriting expertise on sectors through managed products before direct exposure
- Better risk weight than banks

Insurance Companies:

- 3% of the fund size (traditional + shareholder funds) can be invested in AIF
- In low interest rate environment, alternative investments gain attractiveness to buck up yield
- Medium to long term duration of AIFs helps in bridging asset-liability duration gap
- Diversification away from portfolio heavily tilted towards ultra-safe assets

Investor Landscape and considerations

Domestic Retail Investors

- Minimum ticket size – INR 1 crore
- AIFs have seen participation from HNIs/ UHNIs / Single & Multi Family offices
- Investors have found this attractive from a diversification standpoint
- Taxation – less attractive than Mutual Funds due to indexation benefit (for debt funds)
- Liquidity, cash-flow considerations,
- Effectively captures the 'missing middle' segment

International Investors

- Foreign investors (non-FPIs) permitted in all categories of AIF. FPIs can invest in CAT III AIFs only
- Applicability of DTAA benefits makes AIFs attractive for offshore investors
- Rather than feeder vehicle offshore which increases costs, regulation permits direct investments in India-based AIFs
- Would require PAN in India

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- **Manager/ Sponsor Continuing Interest** – Continuing interest can go beyond the regulatory minimum of 2.5% of fund size or INR 5 crores, whichever is less (for CAT I and CATII). Also, Manager/Sponsor can take a call to make their continuing interest subordinate to other investors.
- **Reporting to investors** – frequency of reporting, NAV statements, credit reports on underlying investees, updates on sectors that the fund has invested in via webinars or other literature.
- **Deployment Period** – Shorter deployment periods help maximising return to investors. How conscious the Fund manager is about shortening the commitment to drawdown period speaks a lot
- **Costs and management fee:**
 - **Upfront cost:** Since collected upfront at the time of investment, has a larger impact on investor IRR unless fund duration is sufficiently long to minimize impact. Investors also need to factor in this cost in secondary trading in which holding period could be much lower than initially anticipated
 - **Management fee:** on capital commitment v/s capital contribution

- **Deemed Consents** – None of the legal documents should have a deemed consent clause for any provision
- **Standard Contribution Agreement** – A standard Contribution Agreement signed with all investors speaks highly of transparency at the Investment Manager level. Avoid side letters with specific investors bestowing special privileges
- **Compensatory Payments between investors** – New investor should compensate old investors for income accruing prior to their investment. Best practice is to have an independent valuer value the fund assets for arriving at such payments.
- **Seat in the Investment Committee** – Investors can arrive at a consensus and nominate a member/observer to the Investment Committee

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- **Rights of Investors / Documentation related:**
 - **Contributor Giveback Provisions:** Are contributors under any obligation to return back distributions from the fund post the fund closure? If so, is this capped / limited to a certain period?
 - **Indemnity:** Check for capping of indemnity and number of years post which the indemnity obligation will expire
 - **Representations & Warranties** – Check for Reps & Warranties of Contributors in comparison to the Reps & Warranties of Trustee and IM
 - **Side letters** – Do some investors get special privileges via a side letter which bypasses the Contribution Agreement?
 - **Investment Manager** – Can the Investment Manager be removed by the Contributors for a cause and post a cure period?
 - **Removal of Trustee/Investment Manager** – Can investors change Trustee/IM for a defined “cause” post a cure period based on voting crossing a defined threshold?

- **Restrictions in Secondary Trading** – Has the Trustee/IM put any restriction on secondary market trades by investors?
- **Costs and Expenses**
 - All expenses should be fairly allocated (this usually means equally) between different investors, irrespective of whether the investor is the Sponsor/Manager
 - Equitable mechanism has to be put in place for allocation of set up expenses between all investors, particularly investors who come in the fund during different closes. Best way to do this is to amortize set up cost over the life of the fund.
 - Check for hidden costs, especially inclusion of marketing expenses in operating expenses. Do direct investors bear the brunt of any distribution expenses paid to wealth distributors?

THANK YOU....

Questions?
