

# Specific due diligence of investors and investments of AIFs

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# Background on the circular

In terms of **Regulation 20(20) of SEBI (Alternative Investment Funds) Regulations, 2012 ('AIF Regulations')**, inserted vide notification **dated April 25, 2024**, **every AIF**, Manager of the AIF and Key Management Personnel of the Manager and the AIF shall exercise specific due diligence, with respect to investors and investments of the AIF, to prevent facilitation of circumvention of such laws, as may be specified by SEBI from time to time.

**In this regard, the specific due diligence to be carried out by AIFs, managers of AIFs and their Key Management Personnel, with respect to investors and investments of the AIF, to prevent facilitation of circumvention of the following regulatory frameworks, are being specified in this circular**

## 1. Investors availing benefits designated for QIBs through AIFs

AIFs are now designated as QIBs under **Regulation 2(1)(ss) of ICDR Regulations**, granting them benefits typically reserved for **QIBs under SEBI rules**. However, to prevent ineligible investors from accessing these QIB benefits via AIFs, stricter due diligence is required. Specifically, for any AIF scheme where a single investor or a group of investors contributes **50% or more to the scheme's corpus**, due diligence based on standards set by the Standard Setting Forum for AIFs (SFA) must be conducted before **claiming QIB benefits**

## 2. Investors availing benefits designated for Qualified Buyers (QBs) through AIFs

- AIFs have been recognized as **Qualified Buyers (QBs) under clause (u) of sub-section (1) of section 2 of the SARFAESI Act**, allowing them to invest in Security Receipts (SRs) from Asset Reconstruction Companies (ARCs). To prevent AIFs from enabling ineligible investors to benefit from QB status, the following requirement is in place:
- For any AIF scheme where a single investor or a group contributes **50% or more of the scheme's corpus**, **due diligence based on the implementation standards set by the Standard Setting Forum for AIFs (SFA) must be performed before investing in SRs or claiming QB benefits under the SARFAESI Act.**

### 3. RBI regulated lenders/entities ever-greening their stressed loans/assets through AIFs

To combat the ever-greening of stressed loans by RBI-regulated lenders through AIFs and to ensure compliance with RBI norms on Income Recognition, Asset Classification, Provisioning, and Restructuring, the following measures are mandated

#### For each AIF scheme

- If the manager or sponsor is RBI-regulated, or if investors regulated by **RBI contribute 25% or more of the corpus**, due diligence must be conducted as per SFA standards. This includes investors who are associates of the manager, or those holding majority or veto power in investment decisions.
- If an investor is an AIF or a fund established outside India or in **International Financial Services Centers (IFSCs)**, the due diligence will be assessed on a look-through basis regarding RBI regulation.
- AIF managers must ensure that their schemes do not facilitate indirect acquisitions or exposures by **RBI-regulated lenders in investee companies that they cannot directly acquire.**

### 4. Investment Provisions for AIF Schemes

- AIF schemes must proceed with proposed investments following the implementation standards set by the Standard Setting Forum for AIFs (SFA) as per provisions in paragraphs (as mentioned in previous points) **1,2,3**
- If an investment does not meet the due diligence criteria specified by the SFA
  1. Exclude the investor or investors from the same group **(as specified in the aforementioned paragraphs)** from the investment. Necessary disclosures must be made in the **Private Placement Memorandum (PPM)**.
  2. If exclusion is not feasible, the investment shall not be made.
- Schemes falling under the provisions must also conduct due diligence checks on existing investments held as of the circular date.
- If existing investments do not meet due diligence standards, details must be reported to the custodian of the **AIF by April 7, 2025, using the format specified in Annexure I.**
- If all existing investments meet the required due diligence checks, the AIF manager must submit an undertaking to the custodian by **April 7, 2025, confirming compliance.**

## 5. Investment from countries sharing land border with India through AIFs

- **According to Rule 6(a) of NDI Rules**, individuals or entities from countries sharing a land border with India may invest in Indian companies only with prior government approval.
- For AIF schemes where 50% or more of the corpus is contributed by investors from countries sharing a land border with India:
  - Investors who are either citizens of or situated in countries sharing a land border with India, as well as beneficial owners defined under sub-rule (3) of Rule 9 of the Prevention of Money-laundering (Maintenance of Records) Rules, 2005, must undergo necessary due diligence in accordance with the implementation standards established by the SFA.
  - After due diligence, AIF schemes must report investments where they **hold 10% or more of equity/equity-linked securities in an investee company (on a fully-diluted basis)** to their custodian within 30 days of the investment. The report should follow the format specified by the SFA. Custodians are required to compile this information and report to **SEBI within 10 working days from the end of each month**.
  - For schemes that hold 10% or more of equity/equity-linked securities in an investee company as of the date of this circular, details must be reported to custodians on or before April 7, 2025, in the format specified by the SFA.
  - Custodians must compile all information reported by AIFs (as mentioned in previous points) and submit **it to SEBI by May 7, 2025**.
  - The term 'same group' refers to 'related parties' and 'relatives' as defined in **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015**.
  - AIFs and their managers, along with key management personnel, must adopt the implementation standards developed by the SFA in consultation with SEBI. These standards will be published on the websites of relevant industry associations (**IVCA, PE VC CFO Association, and Trustee Association of India**) **within 1 working day of the issuance of this circular**.

## Impact of the Circular

- Enhanced KMP oversight improves strategic decision-making and compliance, fostering investor confidence.
- Proactive risk identification by KMPs and custodians protects the fund from potential losses and regulatory issues.
- Custodians ensure robust safeguarding of assets, reducing the risk of fraud and mismanagement.
- Ongoing monitoring ensures adherence to evolving regulations, minimizing legal risks and penalties.
- Detailed records from custodians and KMPs enhance transparency, reassuring investors about fund operations.
- Continuous due diligence processes help identify and mitigate potential risks, safeguarding investor interests.



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