

Investment by Regulated Entities in AIFs

RBI has issued instructions dated 19-12-2023 to Regulated Entities (REs).

The Regulated entities (REs) make investments in units of AIFs as part of their regular investment operations. However, certain transactions of REs involving AIFs that raise regulatory concerns have come to RBI's notice. REs which make investments in AIFs which have downstream investments either directly or indirectly in a debtor company of the RE, entail substitution of direct loan exposure of REs to borrowers, with indirect exposure through investments in units of AIFs. In order to address concerns relating to such transactions, the RBI has issued instruction stating that:



“REs shall not make investments in any scheme of AIFs which has downstream investments either directly or indirectly in a debtor company of the RE.”

The debtor company for this purpose has been defined as a Company to which RE currently has or previously had a loan or investment exposure anytime during the preceding 12 months.

Definition of Debtor

It is important to note the following important points in this regard:

- The *debtor Company* for this purpose has been defined *as a Company* to which
- RE *Currently* has or *previously* had
- a *loan* or *investment exposure*
- *anytime* during the *preceding 12 months*

The definition of debtor only includes Company. Further with such Company, there should be a loan or investment exposure of the REs currently or previously anytime during the preceding 12 months. The said instruction has to be complied by the RE at all times i.e. both on making the investment and subsequent monitoring.



Therefore, to ensure compliance with this instruction the REs should ensure the following on the date of making any investment in any AIFs:

- List of debtors of RE anytime during preceding 12 months from the date of proposed investment.
- List of all direct and indirect downstream investment of the AIF's on the date of proposed investment.
- Prompt updated list of direct and indirect downstream investment made by investee AIF's in future.

Regulated Entities

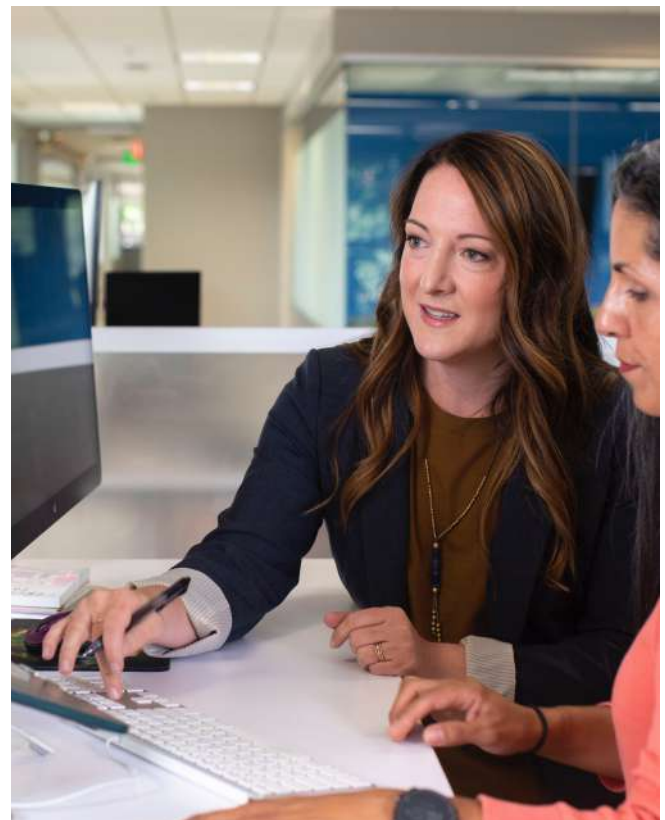
It is pertinent to note that the instruction is addressed to the following:

- All Commercial Banks (including Small Finance Banks, Local Area Banks and Regional Rural Banks) All Primary (Urban) Co-operative Banks/State Co-operative Banks/ Central Co-operative Banks,
- All All-India Financial Institutions
- All Non-Banking Financial Companies (including Housing Finance Companies)

The term Regulated Entities has not been defined for the purposes of this instruction. However, the term Regulated entities has been defined under the Know Your Customer (KYC) Directions 2016 issued by RBI. The said Directions define Regulated entities as follows:

“Regulated Entities (REs) means

- *All Scheduled Commercial Banks (SCBs)/ Regional Rural Banks (RRBs)/ Local Area Banks (LABs)/ All Primary (Urban) Co-operative Banks (UCBs)/State and Central Co-operative Banks (StCBs / CCBs) and any other entity which has been licenced under Section 22 of Banking Regulation Act, 1949, which as a group shall be referred as 'banks*



- *All India Financial Institutions (AIFIs)*
- *All Non-Banking Finance Companies (NBFCs), Miscellaneous Non-Banking Companies (MNBCs) and Residuary Non-Banking Companies (RNBCs)*
- *Asset Reconstruction Companies (ARCs)*
- *All Payment System Providers (PSPs)/ System Participants (SPs) and Prepaid Payment Instrument Issuers (PPI Issuers)*
- *All authorised persons (APs) including those who are agents of Money Transfer Service Scheme (MTSS), regulated by the Regulator”*

Therefore, the applicability of the said instruction on the non-addressee to the instructions may require to be clarified.

Way Forward

The Instructions requires the REs to liquidate any such investments in existing AIF scheme which breach the condition as specified in the Instruction dated 19-12-2023. A time limit of 30 days has been provided to complete the liquidation action for existing investments in AIF scheme from the date of issuance of this circular i.e. 18-01-2024.

If after making investment in AIF scheme there is a downstream investment which results in breach of this instruction, the RE can liquidate the investment in the AIF scheme within 30 days from the date of investment.



In case REs are not able to liquidate their investments within the above-prescribed time limit, they shall make 100 percent provision on such investments.

This instruction bring in the added responsibility to keep a check on the Debtor list of REs and there is no threshold provided.