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Foreign investors turn to AIFs for debt play

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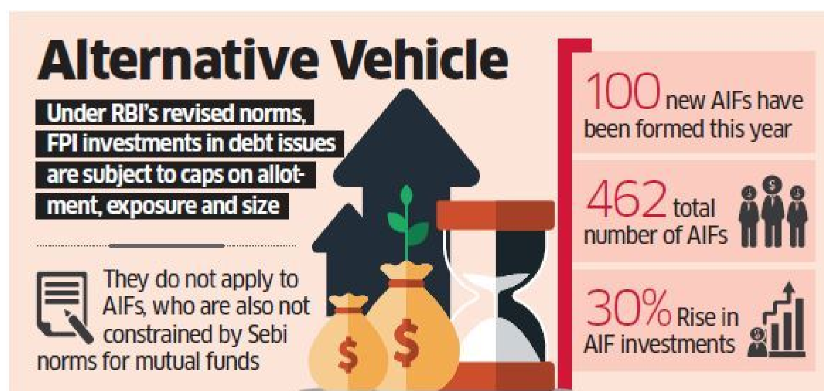
By Pavan Burugula

MUMBAI: The tightening of debt investment rules for offshore entities has sparked a spike in demand for Alternative Investment Funds (AIFs). Several foreign portfolio investors (FPIs) are now using the AIF route to make debt investments in India as the Reserve Bank of India (RBI) curbs don't apply to that avenue. This gives offshore investors the flexibility to participate in several types of private debt issuances.

Almost 100 new AIFs have come into existence this year, adding up to a total of 462, according to Securities and Exchange Board of India (Sebi) data. Investments in AIFs have risen 30 per cent this year to Rs 1.8 lakh crore.

RBI had reviewed the norms for FPI investments in the debt market through a circular in April. An FPI could not be allotted more than 50 per cent of the securities in a single debt issuance. Further, no investment in a single corporate bond could exceed 20 per cent of an FPI's corporate debt portfolio. At the overall portfolio level, shortterm investments were not to exceed 20 per cent of the total investment.



"For long-term FPIs and those who have significant exposure to Indian debt portfolio, the AIF route provides a good alternative," said Rajesh Gandhi, partner, Deloitte. "Investors can either invest in a scheme of a AIF managed by an Indian manager or set up their own AIF."

Tejesh Chitlangi, partner at IC Universal Legal, agreed. "Even from a tax perspective, such investments can be routed through a tax-passthrough category II AIF to avoid leakages," he said.

The restrictions had stalled several deals as they were potentially in violation of the new RBI norms. The impact was most felt in structured deals in the real estate and infrastructure sectors where companies rope in two or three big-ticket FPIs to fully mop up subscriptions.

In the wake of these restrictions, consultants and legal experts started advising clients to set up a special purpose vehicle (SPV) through AIFs to participate in any debt issuances.

“AIFs are considered onshore entities and hence any money pooled by them is considered domestic capital if the manager is owned and controlled by Indians. This attracts fewer investment restrictions, especially in the debt segment,” said Pratibha Jain, partner, Nishith Desai. “Further, AIFs have a light-touch regulatory framework since they cater only to sophisticated investors.”

FPIs initially started evaluating AIF structures a year ago to purchase government securities. Amid the bull market in 2017, the debt limits for FPIs were quickly exhausted. In that scenario, some of the FPIs had considered the AIF structure. The popularity of these structures has increased significantly after the RBI’s debt circular in April, which placed restrictions on investments.

AIFs are pooled funds that cater to wealthy investors. The minimum inticket size is Rs 1 crore. Since these funds don’t have any small or retail investors, regulations are liberal. Unlike mutual funds, AIFs are not subject to restrictions such as sectoral exposure caps or sticking to one class of investments. As per Sebi regulations, there are three categories of AIFs. Category I comprises venture capital funds while category II are debt funds and category III are funds that only invest in listed equities.