CREDAI-MCHI

Ref. No. MCHI/PRES/24-25/005
Date: 03/04/2024

To,

Shri Nitin Gadkari
Hon'ble Minister for Road Transport and Highways
Government of India
Transport Bhawan, Sansad Marg, New Delhi-110001

Sub: <u>RBI circular titled "Investments in Alternative Investment Funds (AIFs)" dated Dec 19, 2023 and March 27, 2024</u>

Respected Sir,

This is with reference to the RBI Circular RBI/ 2023-24/ 90 DOR.STR.REC.58/ 21.04.048/ 2023-24 titled "Investments in Alternative Investment Funds (AIFs)" dated Dec 19, 2023 and RBI/2023-24/140 DOR.STR.REC.85/21.04.048/2023-24 dated March 27, 2024 ("RBI Circular").

BACKGROUND:

1. **AIFs and GoI initiatives**: Today exposure of Regulated Entities ("REs") is estimated by the industry to be 10-12% of the USD 100 billion capital commitments in AIFs. This has been achieved with several years of constructive dialogue with Indian regulators and the Government of India ("GoI"). This is evident from the number of initiatives that the GoI has backed in the AIF space by and through REs, including: (a) Self Reliant Fund (SRI); (b) NIIF; (c) SWAMIH Investment Fund; (d) Neev Fund (backed by UKFCDO), and (e) SIDBI Fund of Fund.

2. **Increase in SEBI oversight on AIFs**: With the growth of this industry, from time to time, SEBI has also increased its scrutiny on AIFs. The level of compliance on fund managers have been increased considerably and the SEBI (Alternative Investment Funds) Regulations, 2012 ("AIF Regulations") no longer remain 'light touch' regulations.

3. **Evergreening of loans is prohibited**: SEBI has prohibited the use of priority distribution model in AIFs in its bid to stop any evergreening of loans that was being undertaken by REs. The RBI Circular states that it has concerns relating to possible evergreening through the AIF route and the RBI Circular has been issued to address this concern.

4. **Ramifications of the RBI Circular**: The RBI Circular has far reaching ramifications on REs and AIFs alike, which goes well beyond the concerns around evergreening. The RBI Circular vastly curtails the ability of REs to invest in AIFs and AIF's ability to seek investments from REs. This will have a significant and deep impact on the AIF industry and adversely affect domestically managed capital formation.

   Further, as a result of the RBI Circular, regular operations of banks undertaken on an arms length basis such as extending working capital facility, credit cards, term loans, project financing to a portfolio company of an AIF in which they are an investor, will run afoul of the stringent measures of the RBI Circular. The RBI Circular is intended to stop evergreening and not services offered by banks as a part of its ordinary course of business. Further to overwhelming response received from Developers, REs and AIFs, we seek to highlight the concerns raised by them and provide our suggestions. Kindly note that the suggestions have been provided keeping in mind the principle that evergreening is prohibited and we unequivocally support and endorse RBI's decision to stop such practices.

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CHALLENGES FACED AND OUR SUGGESTIONS

1) **Exemption to DFIs from the RBI**
Circular The RBI Circular is applicable to development finance institutions ("DFIs") such as SIDBI, NABARD, NABFID, Exim Bank and NHB. DFIs need to be treated differently as: (a) they have very strong governance processes in place and will not engage in evergreening in any manner; (b) they are not part of a fund manager's decision making process on investments/divestments; and (c) they are part of several GoI initiatives on AIFs.
Suggestion: Our request is that the RBI Circular should not be applicable to DFIs.

2) **Non-application of the RBI Circular to banks in limited circumstances**
Master Direction -RBI (Financial Services provided by **banks**) Directions, 2016 states that prior RBI approval is required if a bank is investing more than 10% of the paid up capital/unit capital in a Category I/Category II AIF ("Bank Exposure Limit"). At this threshold, it is not possible for banks to engage in evergreening of their loans through the AIF route.
Suggestion: The RBI Circular should not apply to: (a) banks who have invested in AIFs within the Bank Exposure Limit or (b) banks that have got/may obtain specific approval from the RBI to go beyond the Bank Exposure Limit.

3) **Non-application of the RBI Circular to NBFCs in limited circumstances** Currently, no exposure limits are prescribed for NBFCs investments in AIFs. This may have led to the abuse of the AIF vehicle for evergreening of exposures. The Bank Exposure Limit should be made applicable to NBFCs ("NBFC Exposure Limit") so that NBFCs do not use the AIF route to undertake evergreening of their loans.
Suggestion: The RBI Circular should not apply to: (a) NBFCs who have invested in AIFs within the NBFC Exposure Limit or (b) NBFCs that get specific approval from the RBI to go beyond the NBFC Exposure Limit.

4) **Non-application of the RBI Circular to RE's investment in Category III AIFs**
While banks are not permitted to invest in Category III AIFs, other REs are permitted to do so. Category III AIFs primarily invest in listed securities and any investment by REs in such AIFs cannot result in any evergreening.
Suggestion: The RBI Circular should not apply to investment by REs in Category III AIFs.

5) **Timelines for implementation of the RBI Circular**
(a) Given AIFs are closed ended and illiquid, REs will not be able to comply with the timelines mentioned in the RBI Circular. In that case, REs will be forced to make 100% provision on such investments (beyond what is already prescribed for them).
(b) Till such time as RBI is considering the recommendations from CREDAI and other industry bodies, the RBI Circular should extend the timeline of 30 days given the far-reaching ramifications of the RBI circular on operations of REs and AIFs alike, which have not engaged in evergreening.
(c) For REs that have engaged in evergreening (those that do not fall in the exempt categories that we have highlighted), they should be mandated to limit their exposure to below 10% in an AIF within a period of 6 months from the date of the RBI Circular. We would be happy to provide any additional details and information that you may require for an orderly resolution of these challenges to capital formation caused by the RBI Circular.

We would be happy to provide any additional details and information that you may require for an orderly resolution of these challenges to capital formation caused by the RBI Circular.

Yours sincerely,
For **CREDAI-MCHI**

Domnic Romell	**Dhaval Ajmera**
President	Hon. Secretary

CC 1) Shri Shaktikanta Das, Governor, Reserve Bank of India