RBI’s Revised Guidelines for Lenders in AIFs

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Context

- Recently, RBI set out this clarification: lenders must provision only for the share of money borrowed by a specific investment fund (AIF) in debtor company, not the primary investment.
- In December, RBI altered Prudential Norms by instructing Lenders to sacrifice investments in AIFs that had invested loans to entities to whom Loans were made in the same year or one year ago, or else it was to be 100% provisioned.

Insight into AIF (Alternative Investment Fund)

- An Alternative Investment Fund (AIF) is a privately originating investment vehicle which borrows money from investors for investing in different assets such as equity, debt, real estate, commodity and other such alternative investments.
- Distinct from mutual funds and run by experienced fund managers, AIFs are investment alternatives.
- These vehicles usually target current investors in pursuit of meeting needs other than stocks and monies and yet they may offer high return to their investors and higher risk at the same time.
- AIF is regulated in line with the regulations and standards set by the authority in a given jurisdiction.

Insight into RBI (Reserve Bank of India)

- The Reserve Bank of India (RBI), which has been in existence since 1935, is India's central bank that determines monetary policy, regulates the banking sector, and maintains stability of Indian currency.
- It provides overall regulation by banks and financial institutions, issues licences, and sets the standards of solvency so as to make the banking sector remain stable.
- The RBI is responsible for the management of the currency supply and foreign foreign exchange reserves helping to promote price stability and to ensure that all transactions of the economy are taking place.
- On the top, the system assists financial diffusion and payments and settlement systems that help accessibility and a smooth functionality in banking services.
- The lives of RBI are guided under the supervision of its central board of directors and the institution forms keystone parts of macro-economic policies and comes to terms with public finance of the country. It can achieve this goal by reducing risks, increasing innovation, and generating economic growth that is long-term and sustainable.

RBI's Revised Guidelines related to AIF

- The RBI has revised the framework pertaining to the investment in the Alternate Investment Funds (AIFs), providing relief to the lenders who are boxed in with multifold provisioning charges and nearly impacted investors owing to the severe reduced corpus of their funds. In December, the Reserve Bank of India (RBI) directed the banks and the loan financing companies to dispose of their stakes in alternative investment funds (AIFs) that subsequently invested in firms that received loans from their own loans within RBI's previous one year. This could have been very heavy for us now because we would have had to set aside 100% of the investment amount to cover risks.
- In contrast to this, the last RBI statement underscores that the amount, which AIF invested in the debtor firm, is the only thing, which has to be provisioned by lenders; although, the entire amount, which lender invested in the AIF has to be set aside. Furthermore, besides the straight rule that is in effect with equity shares of the debtor company, the directive covers everything and anything other than these instruments, such as bonds.
- The people-centred happiness indicator is truly the game changer in terms of the change in social metrics. So far, the position of the lender has been that if the lender invests ₹100 crore ($37.7 million) in an AIF ($ Alternative Investment Funds), this AIF has subsequently invested ₹50 crore ($18.9 million) in a debtor entity then the lender has to provide limits ($ amounts of money for which credit is given, a bank or financial Through the clarification, the provisions to the quantum of debt reduced to ₹50 crore, which gained harmony with the actual being of the creditor entity.
- As a consequence of numerous requests of different participants that culminated into a uniform system of compliance with the directives, the RBI has made this revision to its regulations. Although it definitely brings a sigh of relief for banks, the fact that the framework did not extend to the hybrid instrument puts some executives within the industry down. They maintain that at the least, leaving out this section of the criterion may bring about a curious issue and uncertainty, with convertible instruments'

apparent problem being a perfect issue of concern.

- In short, the modifications by the RBI of the AIF investment regulations attempt to reconcile the problems that arise from having to set aside part of incoming funds and remaining compliant with the guidelines on insurance fund investment. Both regulators and market participants must follow these guidelines to preserve uniformity of regulations.

Conclusion

- In conclusion, the Reserve Bank of India's amendments to AIF investment guidelines is a pioneer in this aspect as it shows a flexible attitude to concerns raised by industry participants, offering solace to the lending and investor community.
- Through ensuring that the guidelines are clear and considering any feedback, and thus, the RBI works to contribute to better regulatory effectiveness and financial stability of the sector. Interestingly, however, the hybrid instruments which are not included suggest that the dialogue between regulators and market players needs to be reiterated and should continue.
- In addition, the effect of this set of revisions is the tackling of issues of dynamic nature of regulation together with the realisation of the fact that RBI strives to create a system conducive to investment and development.

Source: *livemint*

UPSC Mains Practice Question

Q.Discuss the recent revisions made by the Reserve Bank of India (RBI) to the guidelines governing investments in Alternative Investment Funds (AIFs).