

SEBI implements direct plan and trail model for AIFs

April 20, 2023

SEBI has introduced few key regulatory changes for Alternative Investment Funds (AIFs) recently, thereby implementing some of the proposals it had made in its consultation papers released in February 2023. These changes include 1) direct plan for schemes and 2) trail model for distribution commission in AIFs (effective May 1, 2023). Broadly, these changes will bring about transparency, reduce mis-selling as well as level the playing field with instruments like Mutual Funds and PMS, which already have a direct plan and trail model on offering.

1. Mandating direct plan for AIF schemes

Earlier, under the AIF Regulations (2012), AIFs had the *option* (not mandate) to offer a direct plan in their private placement memorandum (PPM). AIF regulations permit raising funds via SEBI registered Investment Adviser or Portfolio Manager. In this case, an investor was prone to being double-charged or charged fees at two levels – first, advisory or portfolio management fee and then the AIF distribution fee.

By mandating a direct plan, an investor who approaches the AIF with a SEBI registered intermediary will benefit by saving of expenses on the distribution fee. Consequently, such investors will be assigned higher units, translating into higher returns. This would be beneficial for HNIs & family office investors who largely participate through intermediaries.

2. Trail model for distribution commission in AIFs

Prior to the recent changes, there was no guideline on distribution/placement fee payable for AIF units. This created a potential issue of mis-selling by the distributors due to high upfront payout (could be as high as 3-4% of the committed amount in some cases due to high tenor). In comparison, Mutual Funds and PMS guidelines mandated payment to distributors based on trail commission. To tackle this issue for AIFs, SEBI has introduced the trail model of distribution commissions which shall enhance transparency, reduce mis-selling and remove the commission arbitrage that existed with other products. Particularly:

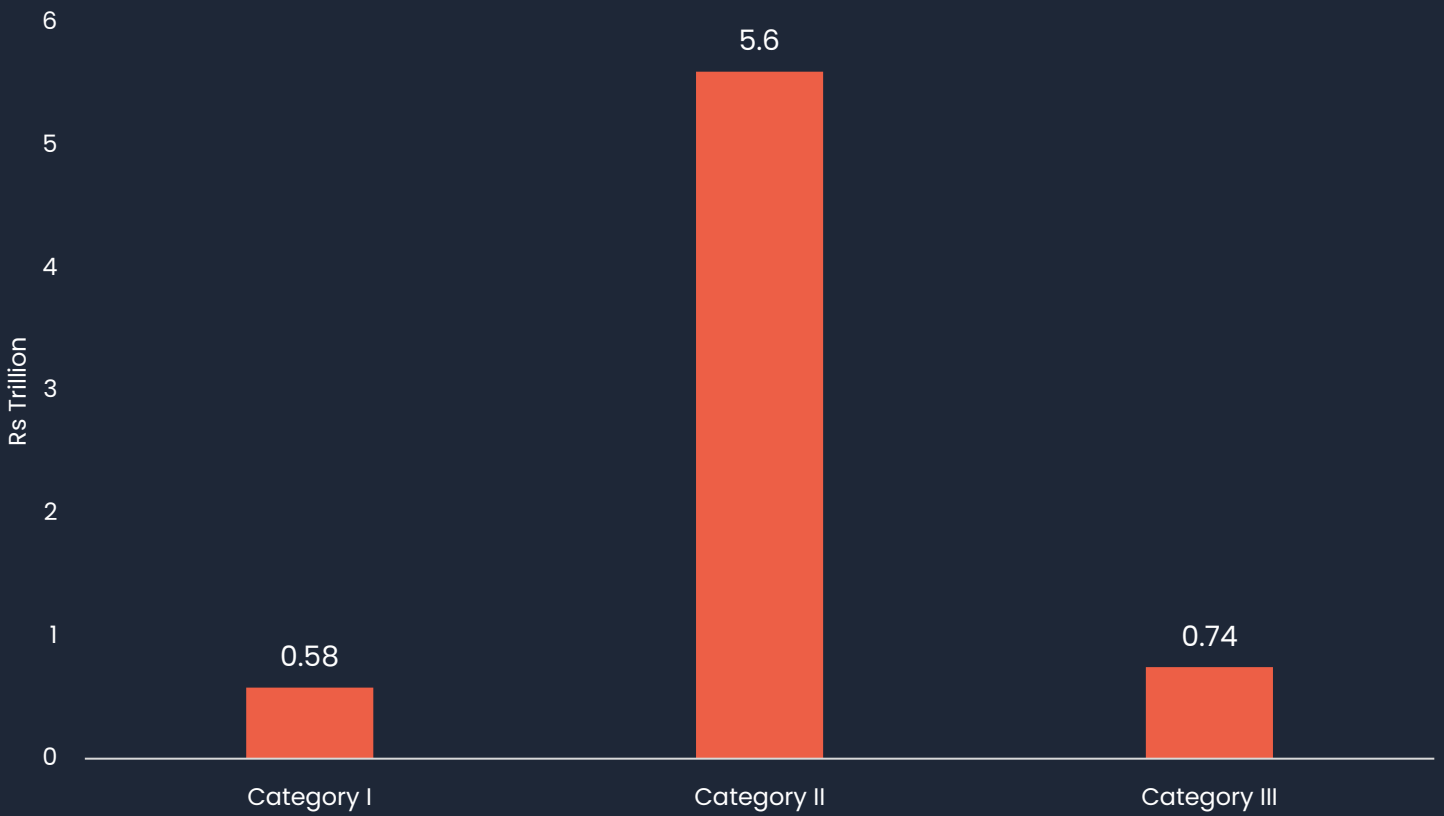
- **Category III AIFs:** distribution fee to be paid on equal trail basis only; no upfront cost will be charged. Further, any distribution fee shall be paid only from the management fee received by the managers of these category of AIFs.
- **Category I and Category II AIFs:** may pay up to 1/3rd of the total distribution fee on upfront basis, and the remaining 2/3rd on equal trail basis over the tenure of the fund.

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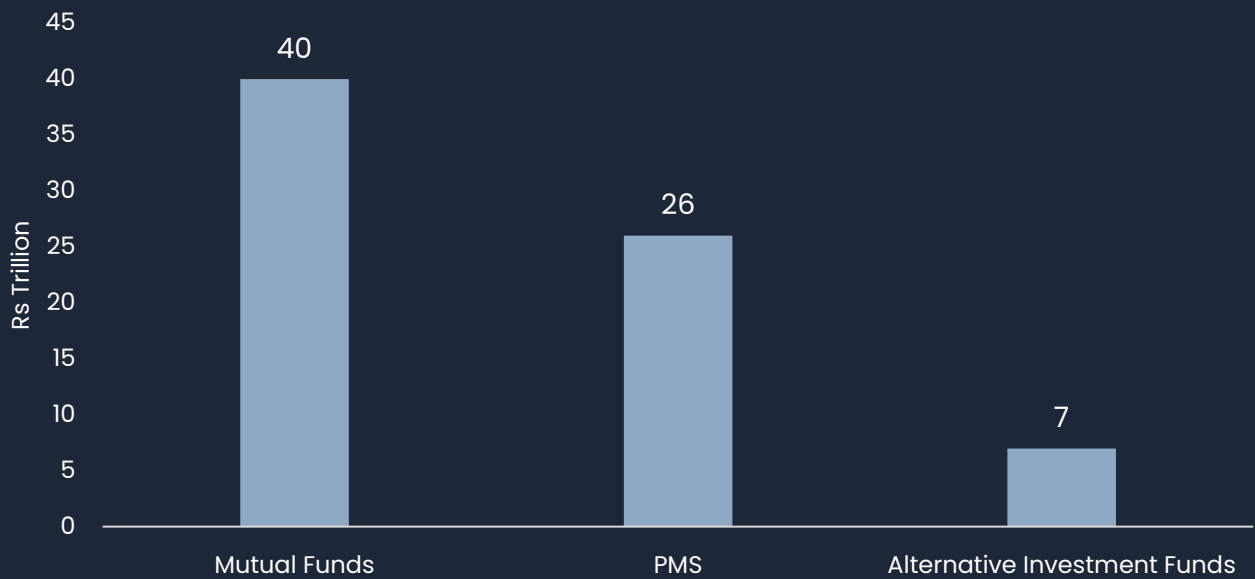
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Commitments raised, by AIF Category*; Total AIF AUM: ~Rs 7 trillion



Assets Under Management, by category^



Source: SEBI, AMFI, Yubi Research; *Data as of June 2022, ^Data as of February 2023, For PMS AUM, ~Rs. 20 trillion of the total is contributed by funds from EPFO/PFs



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