

Consultation paper on direct plan for schemes of Alternative Investment Funds (AIFs)
and trail model for distribution commission in AIFs

Objective

1. The objective of this consultation paper is to seek comments/ inputs/ suggestions from all stakeholders on two proposals; one relating to direct plans for schemes of AIFs, and the other on introduction of trail model for distribution commission in AIFs.

Background

2. Under the SEBI (Alternative Investment Funds) Regulations, 2012 ('AIF Regulations'), AIFs may currently offer a 'direct plan' for investors in their Private Placement Memorandum (PPM) at their option. Such a direct plan would not entail any distribution or placement fees for the investor.
3. Further, AIF Regulations do not place any restrictions on how much of any distribution commission or placement fee can be paid on an upfront basis to intermediaries. It may be noted that, to reduce mis-selling, SEBI (Mutual Funds) Regulations, 1996 and SEBI (Portfolio Managers) Regulations, 2020 mandate that Asset Management Companies and Portfolio Managers should adopt a full trail model of commission to their distributors.

Proposals for consideration

4. **Mandating direct plan for AIF – the issue and the proposal**

- 4.1. AIF Regulations permits AIFs to raise funds from investors only on a private placement basis. An investor may also invest in an AIF through a SEBI registered Investment Adviser or Portfolio Manager.
- 4.2. Investors who look to invest in an AIF through an Investment Adviser or Portfolio Manager, are prone to be charged twice, once in the form of Investment Adviser's advisory fee or Portfolio Manager's portfolio management fee, and separately via the AIF distribution fee.
- 4.3. To address this issue of potential double charge to the investors, a proposal to mandate AIFs to offer the option of direct plan to investors was placed before AIPAC. AIPAC deliberated and recommended the proposal.

Proposal

- 4.4. AIFs to be mandated to offer the option of a Direct Plan for investors, entailing no distribution/ placement fee.
- 4.5. AIFs to ensure that any investor approaching an AIF through an intermediary, that is separately charging the investor a fee (such as advisory or portfolio management fee), invests in the AIF via the direct plan route only.

- 4.6. Investors on-boarded via the direct plan to be provided for an adjusted higher number of units, taking into account the lower distribution charges applicable to them versus other investors, such that all investors would continue to see the same Net Asset value (NAV) on their unit holdings.

5. Trail model of distribution commission in AIF – the issue and the proposal

- 5.1. As mentioned in para 3 above, while Mutual Fund Regulations and Portfolio Managers Regulations mandate trail commissions to distributors (rather than upfront commission) to reduce mis-selling, there are no regulatory guidelines in place with respect to commission/distribution fees in case of AIFs.
- 5.2. Of late, industry feedback suggests that at least in some cases, the quantum of upfront commissions for AIF distribution has gone up to around 4%-5% of committed amount. Such high upfront commissions, particularly in sharp contrast to the trail commissions for other products, increase the chances of mis-selling of AIF schemes.
- 5.3. To address the issue of probable mis-selling of AIFs, and to ensure parity across other SEBI products and offerings, a proposal on adopting trail model of distribution commission in AIFs was placed before AIPAC.
- 5.4. AIPAC deliberated on the proposal and recommended that in case of Category III AIFs, which are somewhat more directly comparable with Mutual Funds/Portfolio Manager Services, investors may be charged placement fee/ distribution fee on a trail basis.
- 5.5. In case of Category I AIFs and Category II AIFs, investors may also be charged on a trail basis, however, certain higher amount of distribution fee (viz: one-third of the present value of the total distribution fee) may be paid upfront in the first year. This is to acknowledge the need for some reasonable incentives to ensure the flow of savings into private capital markets.
- 5.6. A move towards trail model of commission will ensure that the distribution of AIFs is in alignment with the interest of investors, reduce the scope of mis-selling of AIFs. Further, this shall also bring AIFs in parity with regulatory framework for Portfolio Managers and Mutual Funds by removing existing commission arbitrage among these products.

Proposal

- 5.7. In case of Category III AIFs, investors may be charged placement fee/ distribution fee on a trail basis. In case of Category I AIFs and Category II AIFs, investors may also be charged on trail basis, however, certain higher amount of placement/ distribution fee (viz: one-third of the present value of the total distribution fee) may be paid upfront in the first year.

Public Comments

6. Public comments are invited for the proposals at para 4.4, 4.5, 4.6 and 5.7. The comments / suggestions may be provided as MS Excel file as per the format given below:

Name of the person/ entity proposing comments:	
Name of the organization (if applicable):	
Contact details:	
Category: whether market intermediary/ participant (mention type/ category) or public (investor, investee company, academician etc.)	

Sr. No.	Para. no. of the consultation paper	Extract from the consultation paper	Comments / Suggestions	Rationale

7. Kindly mention the subject of the communication as, “Comments on direct plan for schemes of AIFs and trail model for distribution commission in AIFs”.
8. Comments as per aforesaid format may be sent to Shri Sanjay Singh Bhati, Deputy General Manager (ssbhati@sebi.gov.in) and Shri Kunwar Abhay Singh, Assistant Manager (kunwars@sebi.gov.in), latest by February 18, 2023.
