



August 2025

Reserve Bank of India notifies framework governing investments by Regulated Entities in Alternative Investment Funds

The Reserve Bank of India (“**RBI**”) on July 29, 2025, has issued the Reserve Bank of India (Investment in AIF) Directions, 2025 (“**AIF Directions**”) which prescribe regulatory guidelines to govern investments by Regulated Entities (“**REs**”) in Alternative Investment Funds (“**AIF**”). The AIF Directions come into force from January 1, 2026 (“**Effective Date**”), or at an earlier date decided by the respective REs pursuant to its internal policies.

Brief background

With a view to address concerns relating to ‘evergreening’, a practice where REs conceal non-performing loans by pumping fresh funds to an existing borrower through investment in AIFs, the RBI had earlier issued the following circulars dated December 19, 2023, and March 27, 2024 (“**Existing Circulars**”) covering the below key provisions:

1. **Circular dated December 19, 2023:** This circular puts a blanket ban on REs to make any investments in any scheme of AIFs which has downstream investment either directly or indirectly in a debtor company of an RE. If the RE is an existing investor in an AIF scheme, and such scheme intends to make downstream investment in a debtor company, then such RE was required to liquidate its investment in the scheme within 30 (thirty) days from the date of such downstream investment. Further, if REs are unable to liquidate their investments within the above-prescribed time limit, they will make 100 % provision on such investments.
2. **Circular dated March 27, 2024:** Downstream investment as referred in the earlier circular will exclude investments in equity shares of the debtor company of the RE but include all other investments including hybrid instruments. The provisioning requirements as referred in the earlier circular will be required only to the extent of investment by the RE in the AIF scheme which is further invested by the AIF in the debtor company, and not on the entire investment of the RE in the AIF scheme.

After taking into account the industry feedback, as well as the regulations issued by the Securities Exchange Board of India, RBI conducted a thorough review of its Existing Circulars and has issued the AIF Directions which will repeal the Existing Circulars with effect from the Effective Date.

Applicability of the AIF Directions

The AIF Directions will be applicable to investments by the following REs in the units of AIF schemes:

1. commercial banks (including small finance banks, local area banks and regional rural banks);
2. primary (urban) co-operative banks/ state co-operative banks/ central co-operative banks;

3. all-India financial institutions; and
4. non-banking financial companies (including housing finance companies).

Relevant definitions for the AIF Directions

The following 2 (two) definitions as provided in the AIF Directions determine the application of the provisioning requirements:

1. **‘Debtor Company’:** A ‘Debtor Company’ for a regulated entity is defined by reference to any company to which the regulated entity currently has, or had in the preceding 12 (twelve) months, a loan or investment exposure (excluding equity instruments).
2. **‘Equity Instrument’:** Refers to equity shares, compulsorily convertible preference shares and compulsorily convertible debentures.

Key highlights of the AIF Directions

1. **General requirement:** REs are required to include suitable provisions governing investments in AIF schemes within their investment policy, ensuring compliance with applicable laws and regulations.
2. **Limits on investment:**
 - a) No RE will individually contribute more than 10% of the corpus of an AIF scheme.
 - b) The collective contribution by all REs in any AIF scheme will not exceed 20% of the corpus of that scheme.
3. **Provisioning requirements:**
 - a) In case a RE contributes more than 5% of the corpus of an AIF scheme that has downstream instrument (excluding Equity Instruments) in a Debtor Company of the RE, the RE must make 100% provisioning for its proportionate investment in that Debtor Company through the AIF scheme. However, this provisioning is subject to the maximum direct loan / investment exposure of the RE to the Debtor Company.
 - b) Notwithstanding the above provisions (as contained in paragraph 3(a) above), if the RE makes investments in subordinated units, then such RE will deduct the entire investment from its capital funds. This deduction is required to be done proportionately from both Tier-1 and Tier-2 capital (wherever applicable).
4. **Exemptions:**
 - a) The provisions under paragraph 2 above (*Limits on investment*) are not applicable to outstanding investments/commitments of a RE made with the prior approval of the RBI under the provisions of RBI (Financial Services provided by Banks) Directions, 2016.
 - b) The RBI may, in consultation with the Government of India, by a notification, exempt certain AIFs from the scope of the Existing Circulars and the revised AIF Directions (except for paragraph 1 above (*General Requirement*)).
5. **Repeal provisions:**
 - a) The AIF Directions intend to repeal the Existing Circulars with effect from the Effective Date. Any new commitment to contribute by the RE into an AIF scheme, made after the Effective Date, will be governed in terms of the AIF Directions.
 - b) Notwithstanding the aforesaid: (i) any outstanding investment by a RE on the date of issuance of the AIF Directions, in a AIF Scheme in which it has fully honoured its commitment, will be governed by the provisions of the Existing Circulars; (ii) in respect of any investment made by a RE in an AIF scheme in terms of an existing commitment as on the date of the AIF Directions, or in terms of a new commitment entered into

before the Effective Date, the RE must follow, in entirety, the provisions of either the Existing Circulars or the AIF Directions.

Conclusion

The AIF Directions by the RBI marks a significant shift from the earlier blanket restrictions and provides a consolidated framework governing the investments made by REs in AIF. The specified limits on investment and provisioning requirements provide a structured approach to managing risks associated with AIF exposures, particularly in relation to debtor companies. Through the introduction of these AIF Directions, the RBI seeks to mitigate systemic risks, particularly those arising from indirect exposures to debtor companies, while allowing REs to participate in the AIF ecosystem within a regulated boundary. As the AIF Directions come into effect from the Effective Date, REs will need to proactively align their investment policies and risk management frameworks to ensure full compliance and operational readiness under the revised regime.

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This Prism has been prepared by:



Varun Sriram

Partner



Nandini Menon V

Senior Associate



Nithyashree Venkatesh

Associate



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