



Insights Into Alternative Investment Funds In India

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Abstract: This paper provides an in-depth exploration of Alternative Investment Funds (AIFs) in India, their classifications, regulatory framework, advantages, risks, and their comparative positioning against traditional mutual funds. The study further delves into the structure, roles, categories, growth trajectory, and performance metrics of AIFs. By examining data from SEBI and NSE and discussing recent trends, the paper emphasizes the future potential of AIFs in India's growing investment ecosystem. It highlights how AIFs are becoming a preferred choice for HNIs and UHNIs seeking diversified and high-return investment options beyond traditional avenues.

Index Terms - Alternative Investment Funds (AIFs), SEBI Regulations, Category I AIF, Category II AIF, Category III AIF, High Net Worth Individuals (HNIs), Ultra High Net Worth Individuals (UHNIs), Venture Capital, Hedge Funds, Private Equity, Infrastructure Funds, Real Estate Funds, Mutual Funds, Risk-Adjusted Returns, Portfolio Diversification, Tax Pass-Through, Investment Strategies, Fund Performance Metrics, Indian Financial Markets, AIF Growth Trends

I. INTRODUCTION:

Alternative Investment Funds or AIF's are a type of investment option that offers something different from traditional and conventional choices like stocks, bonds, mutual funds, or fixed deposits. They are designed for investors who are looking for higher returns and are willing to take more risk. The type of investors who usually invest in AIF's are high net worth individuals (HNIs), family offices, or big institutions. AIFs collect money from a small group of investors who are usually high net worth individuals and then invest it in alternative assets like startups, real estate, private companies, infrastructure projects, or specific types of funds that give out higher returns. AIFs are more flexible and target areas that normal investment funds usually don't. Alternative Investment Funds were introduced in India in 2012 through SEBI's AIF regulations. Since then AIF industry has grown rapidly. As of March 2025, there are 1593 SEBI registered AIFs in India and the total amount of money managed by Alternative Investment Funds (AIFs) in India reached 13,00,000 crore (US\$149.25 Billion). This reflects a 5 percent increase from quarter to quarter according to the Securities and Exchange Board of India (SEBI).

Alternative Investment Funds are attractive investments for Ultra High Net worth Individuals (UHNIs) and High Net worth Individuals (HNIs) because of the Diversification leading to higher return potential. However, despite the benefits that AIF offers – it does have drawbacks such as higher risks, limited liquidity, and higher management and performance fees. AIF's are categorized or classified into 3 categories by the Securities and Exchange Board of India (SEBI). Category 1 is the type of fund that invests in sectors considered socially desirable such as venture capital, infrastructure, and small and medium enterprises (SMEs). Category 2 is the type of fund that includes private equity funds, debt funds, infrastructure funds, funds of fund, and social

venture funds. Category 3 is the type of fund that employs diverse or complex trading strategies, including hedge funds and Private investments in public equity (PIPE).

II. REGULATORY FRAMEWORK AND KEY PARTICIPANTS:

From a regulatory framework point of view, AIFs operate under the purview of the Securities and Exchange Board of India. Any entity that wishes to operate as an AIF must seek registration from SEBI. The entities that play a major role in an AIF are as follows:

1. Settlor – A settlor is the person who settles the fund with a nominal initial settlement
2. Trustee – In case the AIF is set up as a trust, the trustee oversees the overall administrative and management duties of the trust.
3. Contributor/Investor – The investors whether foreign or Indian are the people who make a capital commitment to the fund.
4. Sponsor – The sponsor is the face of the company who sets up the trust
5. Investment Manager – This person is the brain of the fund who is appointed and entrusted to manage the investments

III. CATEGORIES OF AIFS:

The category 1 AIFs are the funds that employ strategies to invest in startups, early-stage ventures, Social Ventures, Small and Medium Enterprises, Infrastructure Funds or any other government or private sector investments that are economically or socially desirable. The minimum ticket size for such a fund is INR 1 crore and the minimum fund size is INR 20 crore. The category 1 AIF is a close ended fund with a minimum tenure of 3 years. The continuing interest of the sponsor manager is the lower end of 2.5 percent of the corpus which is INR 5 crores. The concentration norm for a Category 1 AIF is that the fund can't invest more than 25 percent in 1 Investee Company. In terms of borrowing, an AIF can't borrow funds except for temporary funds for more than 30 days, less than 4 times a year, and less than 10 percent of investable funds. The SEBI registration fees for an AIF is INR 500,000 and INR 100,000 per scheme. From a taxability perspective, Category 1 and 2 AIF are given a pass-through status as any income earned is not taxed at an AIF level but directly at the hands of the investors.

The category 2 AIFs are the funds that do not undertake leverage or borrowing other than to meet day to day operational requirements and as permitted in AIF regulations. An example of category 2 AIF would be private equity or debt funds. The minimum ticket size for such a fund is INR 1 crore and the minimum fund size is INR 20 crore. The category 1 AIF is a close ended fund with a minimum tenure of 3 years. The continuing interest of the sponsor manager is the lower end of 2.5 percent of the corpus which is INR 5 crores. The concentration norm for a Category 1 AIF is that the fund can't invest more than 25 percent in 1 Investee Company. In terms of borrowing, an AIF can't borrow funds except for temporary funds for more than 30 days, less than 4 times a year, and less than 10 percent of investable funds. The SEBI registration fees for an AIF is INR 1,000,000 and INR 100,000 per scheme. From a taxability perspective, Category 1 and 2 AIF are given a pass-through status as any income earned is not taxed at an AIF level but at the hands of the Investors

The category 3 AIFs are the funds that employ diverse and complex trading strategies and may employ leverage including through investments in listed or unlisted derivatives. Example of Category 3 AIFs include – Hedge Funds and Private Investment in Public Equity (PIPE). The minimum ticket size is 1 crore and minimum fund size is 20 crores. The fund can be open or close ended and tenure is 3 years for close ended fund and for open ended – no tenure is applicable. The continuing interest of sponsor manager is less than 5 percent of the corpus which is INR 10 crores. According to the concentration norms, a category cannot invest more than 10 percent in 1 Investee Company. In terms of borrowing, the AIF can engage in leveraging and borrowing according to prescribed rules. The SEBI registration fees for a Category 3 AIF is INR 1,500,000 and per scheme filing fees is INR 100,000. From a taxability perspective – Category 3 AIFs do not get a pass-through granted status – meaning they do not pass on their tax obligations to their investors. The Trustee who manages the AIF pays the taxes on behalf of the investors just like they would have paid if they had earned the income directly. Furthermore, if the trust earns business income, then the trust is required to pay tax at the maximum marginal rate (MMR) which is the highest rate applicable.

IV. RISE OF AIFS IN INDIA:

In India, you are a (HNI) high net worth individual if your net worth is about INR 5 crores, a very-high net worth individual (VHNIs) if your net worth is between INR 5 crores and INR 25 crores, and a ultra-high net worth individual (UHNIs) if your net worth is above INR 25 crores. As of 2024, there are about 8,00,000 HNI and 13,600 UHNI's. As the number of HNI's and UHNI's rise – there is a significant increase in the rise of AIFs. There is a direct correlation between the rise of HNIs or UHNIs and the rise of AIFs. This direct correlation and the rise in popularity of AIF stems from progressive regulatory development and continuous technological development. Furthermore, HNIs and UHNIs are shifting slowly towards diverse and creative investment strategies that give out potentially higher returns with a little bit of risk. Over the past 6 years, commitment towards Indian AIFs has soared by 378 percent – from 2.82 lakh crores in FY19 to 13.49 lakh crores in Q4FY25. This 5-fold expansion shows significant market potential. Additionally, AIFs in India have begun to reach beyond HNI's and UHNI's due to several factors mentioned below:

- a. AIF's have greater operational flexibility in comparison to mutual funds as the minimum investment threshold is INR 1 crores. Such a setup allows for a less restrictive regulatory environment. This in turn gives fund managers more flexibility in operating and constructing a portfolio that gives out competitive risk adjusted returns.
- b. The enhanced transparency and regulatory support from SEBI through measures such as mandatory dematerialization of AIF holdings leading to increased security and surety of transactions.
- c. The diversifies investment choice that AIF offers through its three categories allows investors to pick and choose the way they prefer to invest their money analyzing the risks and returns of each category. Furthermore, this allows the fund manager to invest across a broad spectrum of assets. This includes debt instruments (venture capital and structures debt), listed equity, unlisted equity, private equity, infrastructure fund, real estate fund, funds of funds, and even derivatives.

As of March 2025, the data relating to Alternative Investment Funds recorded by SEBI (Securities and Exchange Board of India) are as follows:

AIF Funds Raised

AIF - Category 1 – INR 49,373 crores
 AIF – Category 2 – INR 366,621 crores
 AIF – Category 3 – INR 147,435 crores

AIF Funds Invested

AIF - Category 1 – INR 42,931 crores
 AIF – Category 2 – INR 332,201 crores
 AIF – Category 3 – INR 163,029 crores

V. AIFS VS MUTUAL FUNDS:

The choice between investing in Mutual Funds or Alternative Investment Funds includes multiple factors such as investment amount, willingness to take risk, diversification preferences, personal preferences, regulatory restrictions, asset type, liquidity, taxation, and so on. We look at several of the above-mentioned factors to compare the differences between investing in AIF and MF:

- a. Net worth Factor/Income Factor – People who usually invest in AIFs are HNIs and UHNIs as the minimum investment requirement is INR 1 crore whereas in Mutual Funds – one can invest as low as INR 100 per month through the Systematic Investment Plan (SIP)

- b. Regulation – Both AIF's and MFs are regulated by SEBI. However, SEBI regulations are more stringent for Mutual Funds than they are for Alternative Investment Funds.
- c. Asset Type – The type of assets that Alternative Investment Funds invest in include Real Estate, Hedge Funds, Private Equity, Infrastructure Fund, Venture Capital, Derivatives whereas the type of assets that Mutual Fund invests in include Stocks, Gold, Government Securities, and Bonds.
- d. Liquidity – AIFs tend to have a commitment period wherein investors are typically not allowed to redeem the fruits of their investment. This is to ensure that the capital allocation goes smoothly and effectively, and the expected risk adjusted return is achieved. This allows the fund manager to achieve the fund's objectives. Mutual Funds are usually more liquid, but they also have a lock in period of 3 years.
- e. Risk – AIFs tend to carry more risk due to their complex and diverse strategies to maximize returns. Mutual Funds also have risks but comparatively much lower as they invest in traditional or conventional assets such as stocks, bonds, and commodities.

Choosing Alternative Investment Funds (AIF) is a logical move if you are able to allocate huge amounts of capital, willing to take risks, wait for your risk adjusted potentially high returns, ready for a lock in period, and invest in non-traditional assets.

Choosing Mutual Funds (MFs) is a logical move if you want to invest less money, want a lower lock in period, want less risk, and a moderate risk adjusted return, and wish to invest your money into traditional assets such as stocks, bonds, and commodities.

VI. PERFORMANCE OF AIFS OVER A 10 YEAR PERIOD:

We can track the performance of AIFs over a 10-year period by using the NSE Indices Performance Highlights. They consider the following factors in their report:

- a. Vintage Year – Year the investment was made.
- b. Scheme Count – Number of Individual AIF Schemes being considered for analysis in the vintage year.
- c. Pooled XIRR – It is the internal rate of return calculated across all cash flow of pooled analysis. A higher value of Pooled XIRR indicates that the fund has performed well and generated strong annualized returns whereas a lower value of pooled XIRR would indicate that the fund has underperformed and has not met expectation or benchmark.
- d. Pooled DPI – DPI (Distributions to Paid in Capital) measures how much capital has been returned to investors relative to what they have invested. A pooled DPI of less than 1 would indicate that the fund has not returned the capital invested. A pooled DPI of exactly 1 would indicate that the fund has returned the capital invested in. A pooled DPI of more than 1 would indicate that the fund has generated profit.

e. Pooled RVPI – RVPI (Residual Value to Paid in Capital) indicates the current unrealized value of the funds remaining investments. A high RVPI would indicate significant value still held in portfolio and a low RVPI would indicate most value still already realized on underperforming.

f. Pooled TVPI – TVPI (Total Value to Paid in Capital) measures the total value (realized and unrealized) generated by the fund relative to the capital invested. A pooled TVPI greater than 1 would indicate that the fund has generated value and anything less than 1 would indicate that the fund is underperforming.

Based on the above-mentioned terms and values, we can now understand how the fund was performing in a given vintage year by looking at the Pooled DPI, Pooled RVPI, and Pooled TVPI.

NSE INDICES Performance Highlights for Alternative Investment Funds (AIF's) for 10 Years for Category 1

Performance Highlights – September 2024

CATEGORY I

CATEGORY I

Vintage Year	Scheme Count	INR				USD			
		Pooled XIRR (%)	Pooled DPI	Pooled RVPI	Pooled TVPI	Pooled XIRR (%)	Pooled DPI	Pooled RVPI	Pooled TVPI
FY 2014	5	11.04%	1.26	0.59	1.85	7.49%	1.06	0.46	1.53
FY 2015	7	8.22%	1.16	0.46	1.62	5.39%	1.02	0.35	1.37
FY 2016	17	21.63%	0.79	2.43	3.22	18.00%	0.69	1.99	2.68
FY 2017	10	29.46%	0.71	2.25	2.96	25.15%	0.65	1.96	2.60
FY 2018	8	23.69%	0.64	1.38	2.01	19.74%	0.59	1.23	1.83
FY 2019	10	26.30%	0.07	2.44	2.51	22.32%	0.07	2.16	2.23
FY 2020	16	20.77%	0.08	1.65	1.73	16.77%	0.08	1.50	1.58
FY 2021	4	13.22%	0.01	1.35	1.37	9.47%	0.01	1.24	1.26
FY 2022	6	14.57%	0.00	1.24	1.24	11.49%	0.00	1.19	1.19
FY 2023	15	10.13%	0.03	1.07	1.10	8.60%	0.03	1.06	1.09
FY 2024	4	25.84%	0.04	1.15	1.19	24.99%	0.04	1.14	1.18
Total Schemes	102								

Data as of 30th September 2024; Returns and multiples are calculated on a post-expenses, pre-carry, and pre-tax basis.
DPI: Distributions to paid-in capital, RVPI: Residual Value to paid-in capital, TVPI: Total Value to paid-in capital
Benchmark metrics are published starting from that vintage year in which at least 2 schemes are available.
RBI reference rates are used for calculation of metrics in USD terms.
Please refer the full report for complete scheme eligibility criteria and number of schemes excluded from calculation of above benchmarks

NSE INDICES Performance Highlights for Alternative Investment Funds (AIF's) for 10 Years for Category 2

Performance Highlights – September 2024

CATEGORY II

CATEGORY II

Vintage Year	Scheme Count	INR				USD			
		Pooled XIRR (%)	Pooled DPI	Pooled RVPI	Pooled TVPI	Pooled XIRR (%)	Pooled DPI	Pooled RVPI	Pooled TVPI
FY 2014	9	6.41%	1.12	0.03	1.14	3.81%	1.06	0.02	1.08
FY 2015	8	6.11%	0.86	0.48	1.33	3.25%	0.79	0.38	1.16
FY 2016	15	13.42%	1.01	0.81	1.82	10.29%	0.92	0.66	1.58
FY 2017	30	12.57%	0.83	0.76	1.59	8.91%	0.76	0.63	1.39
FY 2018	39	15.83%	0.76	0.94	1.70	11.89%	0.70	0.81	1.51
FY 2019	52	19.95%	0.56	1.10	1.66	16.11%	0.53	0.99	1.52
FY 2020	51	14.48%	0.51	0.81	1.32	10.82%	0.49	0.74	1.24
FY 2021	34	14.94%	0.72	0.58	1.29	10.90%	0.69	0.52	1.21
FY 2022	84	13.29%	0.28	0.97	1.25	9.59%	0.27	0.91	1.18
FY 2023	92	16.58%	0.16	1.04	1.20	14.80%	0.15	1.02	1.18
FY 2024	34	14.49%	0.11	0.97	1.09	13.54%	0.11	0.97	1.08
Total Schemes	448								

Data as of 30th September 2024; Returns and multiples are calculated on a post-expenses, pre-carry, and pre-tax basis.

DPI: Distributions to paid-in capital, RVPI: Residual Value to paid-in capital, TVPI: Total Value to paid-in capital

Benchmark metrics are published starting from that vintage year in which at least 2 schemes are available.

RBI reference rates are used for calculation of metrics in USD terms.

Please refer the full report for complete scheme eligibility criteria and number of schemes excluded from calculation of above benchmarks

NSE INDICES Performance Highlights for Alternative Investment Funds (AIF's) for 10 Years for Category 3

Performance Highlights – September 2024

CATEGORY III

CATEGORY III

Period	Benchmark Returns		Public Market Indices Returns (INR)		
	Asset Weighted INR	Asset Weighted USD	NIFTY 50 TR	NIFTY TOTAL MARKET TR	NIFTY COMPOSITE DEBT TR
Since Inception*	16.10%	13.11%	16.03%	18.46%	8.23%
5 Years	18.53%	14.60%	18.98%	22.76%	7.14%
3 Years	14.31%	9.85%	14.94%	18.96%	6.00%
2 Years	22.74%	21.18%	24.24%	29.78%	8.35%
1 Year	31.26%	30.30%	33.00%	42.12%	9.12%

Data as of 30th September 2024; Total schemes considered for above analysis – 269

Returns are calculated on a post-expenses, pre-carry, and pre-tax basis.

RBI reference rates are used for calculation of metrics in USD terms.

*Indices have been created from the quarter in which at least three schemes were available i.e., September 2013

Please refer the full report for details of complete scheme eligibility criteria and number of schemes excluded from calculation of above benchmarks

VII. GROWTH OF AIFS IN 2025:

According to SEBI, the commitments raised by the AIF industry the commitments raised by the AIF industry has reached INR 13.5 lakh crores or roughly 162.5 billion dollars. The commitments increased by 20 percent in FY25 from INR 11.35 lakh crores in FY24. Below mentioned are data relating to the growth of AIF's in 2025 category wise

Category 1:

Commitments (as of March 2025) – INR 89,100 crores
 Commitments (as of March 2024) – INR 76,900 crores
 Growth in Commitments (from previous financial year) – 15 percent
 Funds Raised (as of current financial year) – INR 49,400
 Funds Raised (as of previous financial year) – INR 40,800 crores
 Growth in Funds Raised - 21 percent
 Highest Commitments – Venture Capital Funds
 Second Highest Commitments – Infrastructure Funds
 Third Highest Commitments – Angel Funds

Category 2:

Commitments (as of March 2025) – INR 10.3 Lakh crores
 Commitments (In Financial Year 2025) – INR 9.14 Lakh crores
 Growth in Commitments (from previous financial year) – 13 percent
 Fund Raised (as of current financial year) – INR 3.67 lakh crore
 Funds Raised (as of previous financial year) – INR 3.21 lakh crore
 Investments Made (In one year period) – INR 3.32 lakh crore
 Growth in Investments Made – 20 Percent

Category 3:

Commitments (as of March 2025) – INR 2.3 Lakh crores
 Growth in Commitments (from previous year) – 60 percent
 Funds Raised (as of current) – INR 1.47 Lakh Crores
 Funds Raised (before) – INR 90,000 crores
 Growth in Funds Raised – 64 Percent
 Investments Made (in one year period) – 1.63 lakh crores
 Growth in Investments – 65 Percent

VIII. FUTURE OF AIFS IN INDIA:

Alternative Investment Funds are rapidly changing the landscape of investing. With the increase in the number of HNIs, VHNIs, and UHNIs – there is an increase in the commitment towards AIFs along with the funds raised and capital invested. The future of AIFs is looking promising with the recent new trends shaping the landscape in 2025. Whether it is the rise of HNIs or Investors wanting a diversified portfolio with risk adjusted higher returns or the expected new regulations that will allow for easier registration of AIFs – Everything leads to one clear realization which is that AIF sector is certain for substantial growth.

Some of the factors that lead to AIFs being poised for growth are as follows:

- a. Demand for ESG focused AIFs with Global Trends catching on
- b. Simplified AIF registration process due to Government Regulations
- c. Diversification of the portfolio and higher risk adjusted returns
- d. Growth of startups in India leading to – VCFs, Micro VCs, Angel Funds

- e. Technology driven AIFs and incorporation of Quantitative Data Analysis Software
- f. Government Policies and Tax Incentives (specifically applicable to Cat 1 and Cat 2)
- g. Increased focus on Real Estate AIFs as they have the highest commitment across all Cats
- h. Increased global opportunities and cross border AIFs

IX. CONCLUSION:

To sum up, AIFs are an attractive way to diversify portfolio and potentially achieve higher returns, but it is important to understand and adhere by the regulations presented by the regulatory government bodies which in this case is SEBI. Furthermore, the regulatory environment overseeing and governing AIFs have evolved in the recent years giving fund managers and investor's clarity and flexibility. This leads to smoother operations within an AIF which eventually contributes to the success of AIFs in the Indian Financial Markets. Additionally, Alternative Investment Strategies such as Hedge Funds, Venture Capital, Real Estate Funds, Infrastructure Funds, and Private Equity have demonstrated and proven to be great success for AIFs. In conclusion, while AIFs present promising opportunities for investors seeking higher returns and portfolio diversification, with it also comes inherent risks that must be understood and carefully managed.

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