

Amendment to SEBI (Alternative Investment Funds) Regulations, 2012

1. Objective

This Board Memorandum proposes to amend the SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”) to specify:

- a) timeline for declaration of First Close of schemes of Alternative Investment Funds (AIFs);
- b) calculation of tenure of close-ended schemes of AIFs;
- c) ring-fencing of assets and liabilities of schemes of AIFs and
- d) regulatory provisions with regard to change in control of manager/sponsor and change in manager/sponsor of AIFs.

2. Issues for consideration

2.1 Timeline for declaration of First Close of schemes of AIFs

2.1.1. In terms of Regulation 12(1) of AIF Regulations, AIFs may launch schemes subject to filing of the Private Placement Memorandum (PPM) of the scheme with SEBI. Presently, AIF Regulations do not specify the period within which a scheme shall be launched by an AIF.

2.1.2. Of late, certain AIFs have informed that they have launched their schemes, wherein it was observed that PPMs of such schemes were filed with or taken on record by SEBI more than 4 years ago. Such outdated PPMs may not have disclosures that are in line with the current regulatory requirements. AIFs may seek commitment from investors, based on the information and disclosures provided in such outdated PPMs.

2.1.3. It is further observed from the analysis of investment reports submitted by AIFs for the quarter ended on June 30, 2022, that there are 213 schemes, where PPMs were taken on record by SEBI more than 1 year ago and which have not raised any commitments from investors. Ageing analysis of such schemes is as under:

Ageing	No. of Schemes
> 3 years	98
2-3 years	51
1-2 years	64
Total	213

2.1.4. In this regard, it is noted that timelines have been specified for launch of scheme/offer documents in other regulatory frameworks, which are as under:

- a) In terms of Clause 1.3(2) of Master Circular for Mutual Funds, a scheme of Mutual Fund is required to be launched within six months from the date of the issuance of final observations from SEBI and if the AMC intends to launch the scheme at a date later than six months, it is required to re-file the Scheme Information Document with SEBI under Regulation 28(1) of SEBI (Mutual Funds) Regulations, 1996 along with filing fees. It is understood that the launch of scheme here refers to opening of New Fund Offer (NFO) Period.
- b) In terms of Regulation 14(11) of SEBI (Real Estate Investment Trusts) Regulations, 2014 and Regulation 14(4)(I) of SEBI (Infrastructure Investment Trusts) Regulations, 2014, the initial offer or follow-on offer or rights issue is required to be made by SEBI registered Real Estate Investment Trust (REIT) and Infrastructure Investment Trust (InvIT) within a period of not more than one year from the date of issuance of observations by the Board, provided that if the initial offer or follow-on offer or rights issue is not made within the specified time period, a fresh draft offer document is required to be filed.
- c) International Financial Services Centres Authority (IFSCA) in April 2022 notified the IFSCA (Fund Management) Regulations, 2022, which, inter-alia, prescribed the validity of the placement memorandum of AIFs as 6 months from the date of filing with IFSCA or the date of observation letter of IFSCA, whichever is later.

- 2.1.5. At the same time, AIF Regulations do not specify what constitutes 'launch' of a scheme. It is observed that there is no uniform practice in the AIF industry which defines an event as 'launch' of scheme. In common parlance, 'launch' of scheme can be construed as the date from which the AIF begins seeking commitment from prospective investors. However, it is difficult to objectively ascertain or verify the same. In view of the above, it is felt that it would not be appropriate to specify a validity timeline for PPM, which correlates with 'launch' of scheme.
- 2.1.6. In terms of AIF Regulations, corpus of scheme of an AIF means the total amount of funds committed by investors to the scheme by way of a written contract or any such document (usually the Contribution Agreement entered between the AIF and its investors) as on a particular date. As and when the investment opportunities are identified as per the defined investment objective of the scheme, funds are drawn down by AIFs for investment out of the capital commitments provided by the investors.
- 2.1.7. It may not always be possible for close ended schemes of AIFs to raise commitments from investors for the entire targeted corpus within a limited timeframe, i.e., within a single Closing. Therefore, such AIFs generally declare different closings such as 'First Close' / 'Initial Close' and subsequent closes, depending upon the said scheme reaching certain milestones of the targeted corpus. The last closing declared by the close ended scheme of an AIF, termed as 'Final Close', is the day beyond which the scheme does not on-board any new investor or raise fresh commitments. However, open ended schemes of Category III AIFs may on-board new investors or accept fresh commitments at any point of time.
- 2.1.8. With this background, a need was felt to prescribe a timeline for AIFs to launch their schemes, after the PPM of the scheme is taken on record by SEBI.
- 2.1.9. Accordingly, an agenda proposing to specify timelines for AIFs to launch their schemes was discussed in the meeting of Alternative Investment

Policy Advisory Committee ('AIPAC') held on July 26, 2022. AIPAC, after deliberation, recommended the following:

- a) Since 'launch' of scheme is not verifiable, a scheme of AIF may be 'deemed launched' at the expiry of 3 months from the date of SEBI communication for taking the PPM of the scheme on record.
- b) Declaration of closings is an industry need and a common practice. The First Close is the initial closing upon which AIFs are able to obtain certain level of commitments from its investors, which is an ascertainable / verifiable event, after which the AIF can drawdown funds from the investors for making investments.
- c) Thus, it may be specified that AIFs shall declare First Close of their schemes on a date not later than 12 months from the aforementioned 'deemed launch' of the scheme i.e. not later than 15 months from the date of SEBI communication for taking the PPM of the scheme on record.
- d) The existing schemes of AIFs which have not declared their First Close so far, may be granted a specific period from the date of the notification of the proposed requirement, to declare their First Close, subject to filing of their updated PPMs with SEBI.

2.1.10. Upon internal deliberation, it was viewed appropriate to specify timelines for validity of PPMs, which may be linked to First Close of the scheme.

2.1.11. Further, a need is also felt to prescribe a minimum threshold for defining the event that shall be referred as 'First Close' for the sake of uniformity in the industry. In this regard, it is noted that AIF Regulations specify certain minimum corpus for each category/sub-category of AIFs in the following manner:

Category / Sub-category	Minimum corpus requirement (INR)
Category I AIF – Special Situation Funds	100 crore
Category I AIF – Venture Capital Fund – Angel Funds	5 crore
Category I AIF – Social Impact Funds	5 crore
Other sub-categories of Category I AIFs	20 crore
Category II and Category III AIFs	20 crore

- 2.1.12. The regulatory intent behind specifying the aforesaid minimum corpus for AIFs is, inter alia, that AIFs start making investments only after attaining a specified minimum corpus, even if the proposed target corpus of the scheme is equivalent to prescribed minimum corpus.
- 2.1.13. Since, an AIF can drawdown funds for investment after declaring the First Close, it may be appropriate that the corpus of a scheme at the time of declaring First Close should not be less than the minimum corpus specified for respective category or sub-category of the AIF Regulations. In case of open ended schemes of Category III AIFs, the First Close may refer to the Close of Initial Offer Period, post which the scheme may start making investments.
- 2.1.14. To ensure that the sponsor or manager does not commit higher amounts to the scheme just to meet the requirement of minimum corpus at the time of First close, it may be mandated that the commitment provided by sponsor or manager at the time of declaration of First Close, shall not be reduced or withdrawn or transferred, post First Close.
- 2.1.15. Further, it is also understood that, it is an industry practice to start pre-marketing of the scheme, before the PPM of the said scheme is filed with SEBI. Thus, the solicitation of indicative commitments from prospective investors effectively starts much before filing the PPM with SEBI. Subsequent to SEBI taking the PPM on record, the investor commitments are formalised by executing contribution agreements between the investors and the AIF. Considering the same, it would be appropriate to prescribe a

timeline of 12 months from the date of SEBI communication for taking the PPM on record, for declaration of First Close of the scheme.

Proposal:

2.1.16. Taking into account the recommendations of AIPAC and internal deliberation, it is proposed that AIF Regulations may be suitably amended to facilitate specifying the manner in which First Close of schemes of AIFs may be declared, post which AIFs can start making investment.

2.1.17. The timeline for declaring First Close of a scheme of AIF, along with the minimum corpus at which the First Close is declared, may be prescribed by way of circular, as under:

a) AIFs shall be required to declare the First Close of a scheme not later than 12 months from the date of SEBI communication for taking the PPM of the scheme on record.

Provided that in case of open ended schemes of Category III AIFs, the First Close shall refer to the close of its Initial Offer Period.

b) Corpus of the scheme at the time of declaring First Close shall not be less than the minimum corpus prescribed for the respective category/sub-category of the AIF in AIF Regulations.

c) The commitment provided by sponsor or manager at the time of declaration of First Close to the extent to meet the minimum corpus requirement, shall not be reduced or withdrawn or transferred, post First Close.

d) Existing schemes of AIFs, who have not declared their First Close, shall be required to declare their First Close not later than 12 months from the date of issuance of the circular.

Existing schemes of AIFs, whose PPMs were taken on record prior to 12 months from the date of issuance of the circular in this regard and have not declared their First Close, shall be required to submit updated PPM with SEBI in the format specified in SEBI circular SEBI/HO/IMD/DF6/CIR/P/2020/24 dated February 05, 2020, through a SEBI registered merchant banker along with undertaking by the merchant banker as specified in Annexure A of SEBI Circular SEBI/HO/IMD/IMD-I/DF6/P/CIR/2021/645 dated October 21, 2021 and such updated PPM shall be circulated to investors before declaration of First Close.

- e) Considering that, Large Value Funds for Accredited Investors (“LVFs”) are exempted from Regulation 12(2) and Regulation 12(3) of AIF Regulations and thus, can launch schemes upon filing of PPM with SEBI, LVFs shall be required to declare First Close not later than 12 months from the date of grant of registration or date of filing of PPM of scheme with SEBI, whichever is later.
- f) Existing LVF schemes shall be required to declare their First Close not later than 12 months from the date of issuance of circular in this regard.
- g) In case an AIF fails to declare the First Close within the timeline prescribed above, the AIF shall be required to file a fresh application for launch of the scheme as per applicable provisions of AIF Regulations by paying requisite fee to SEBI.

2.2. Calculation of tenure of close-ended schemes of AIFs

2.2.1. To facilitate that AIFs calculate their tenure in a uniform manner, it was specified in SEBI Circular CIR/IMD/DF/7/2015 dated October 1, 2015, that the tenure of any scheme of the AIF shall be calculated from the date of Final Close of the scheme.

2.2.2. However, AIF Regulations do not specify any timeline or manner for declaring the Final Close. It is observed from the PPMs that AIFs specify a

timeline for declaring Final Close in the PPM, which is generally a fixed period calculated from the date of First Close. However, the manager of AIF invariably has the discretion to extend the timeline for declaring the Final Close.

- 2.2.3. Since, tenure of the scheme is calculated from Final Close, each extension in Final Close by the manager may result in extension of overall tenure of the scheme, thus adversely affecting the investment horizon of the investors i.e. the length of time that an investor has to remain invested in the AIF.
- 2.2.4. To address the aforesaid issue, it is felt that tenure of a scheme may be calculated from a definite point of time so that the investor shall have a clear timeframe to stay invested in the scheme of the AIF. As stated above, since First Close is being proposed as an event with definite timeline for a scheme of the AIF, it would be appropriate to calculate the tenure of scheme from the date of First Close.
- 2.2.5. At the same time, in order to not affect their flexibility, AIFs may continue to be allowed to decide the tenure of the scheme, howsoever long it may be, as each investor would be aware of the overall tenure before making investment in the AIF. Further, AIFs may also be allowed to modify their tenure till the declaration of First Close. To ensure that the interest of the investors is not affected due to such modification in tenure of the scheme, the investors may also be allowed to withdraw or reduce commitment provided to the scheme, prior to declaration of First Close of the scheme.
- 2.2.6. Further, only existing schemes of AIFs, which have declared their First Close, may continue to calculate their tenure from the date of Final Close in terms of SEBI Circular dated October 1, 2015.
- 2.2.7. In this context, an agenda in this regard was discussed in the meeting of AIPAC held on September 13, 2022. AIPAC after deliberation recommended the aforesaid proposals.

Proposal:

2.2.8. Taking into account the recommendations of AIPAC and internal deliberation, it is proposed that AIF Regulations may be suitably amended to facilitate specifying the manner in which the tenure of close ended schemes of AIFs may be calculated.

2.2.9. It is proposed that the following may be specified by way of circular:

- a) The tenure of close ended schemes of AIFs shall be calculated from date of declaration of its First Close.
- b) AIFs may modify the tenure of the scheme at any time before declaration of First Close and the investor may also withdraw or reduce commitment provided to the scheme, prior to declaration of First Close of the scheme.
- c) Existing schemes of AIFs which have declared their First Close, may continue to calculate their tenure from the date of Final Close in terms of SEBI Circular dated October 1, 2015.
- d) Existing schemes of AIFs, which have declared their First Close, and are yet to declare Final Close, shall declare the Final Close as per the timeline provided in the PPM of the scheme and the AIF/manager shall not have any discretion to extend the said timeline provided in the PPM.

2.3. Ring-fencing of assets and liabilities of schemes of AIF

2.3.1. In terms of AIF Regulations, AIFs can launch multiple schemes under a single AIF registration with SEBI. Each scheme under an AIF may have separate sets of investors and different investment portfolios. Therefore, SEBI, vide circular dated October 01, 2015, specified that all managers of AIFs shall ensure scheme-wise segregation of bank accounts and securities accounts.

2.3.2. In this regard, SEBI has received a representation from an AIF industry association stating that majority of SEBI registered AIFs are set up as trusts and many of these AIFs have multiple schemes under the same trust, which is permissible under AIF Regulations. Although industry has represented that there is an ambiguity on whether schemes of an AIF enjoy the same treatment as AIFs themselves or whether any distinction exists between them, it is understood from the industry representation and the information submitted by AIFs with SEBI, that generally AIFs obtain separate Permanent Account Numbers from Income Tax Department for each of their schemes. Thus, each scheme of an AIF is understood to be assessed separately for taxation purpose, even though they are set-up under the same AIF/trust.

2.3.3. With this background, industry association submitted that presently, unlike SEBI (Mutual Funds) Regulations 1996, there is no specific provision in AIF Regulations for ring-fencing and segregation of assets between schemes of an AIF. This leads to uncertainty among investors of AIF, especially among foreign investors, with respect to protection of their assets in a scheme of an AIF from any liability which may arise from other schemes of the same AIF. Accordingly, industry requested that clarity be provided in this regard within AIF Regulations.

2.3.4. As per the SEBI database, it is observed that AIFs have multiple schemes under a single registration, details of which are as under:

Number of schemes under an AIF	Number of AIFs
≥ 2	109
≥ 5	18
≥ 10	6

(As on June 30, 2022)

2.3.5. It is noted that the Code of Conduct specified for the Asset Management Company and Trustees of Mutual Funds in SEBI (Mutual Funds) Regulations, 1996, provides that Trustees and asset management companies shall ensure that the assets and liabilities of each scheme are

segregated and ring-fenced from other schemes of the mutual fund; and bank accounts and securities accounts of each scheme are segregated and ring-fenced.

2.3.6. Similarly, Code of Conduct and Obligations of the Fund Management Entity and Fiduciaries (Directors / Designated Partners / Trustees of the Fund) in International Financial Services Centres Authority (Fund Management) Regulations, 2022, provides that the Fund Management Entity and based on the legal structure of the fund/scheme, the Board of Directors in case of Company, Designated Partners in case of LLP and Trustees (including the Board in case of a Trustee company) in case of a Trust, shall ensure that the assets and liabilities of each scheme are segregated and ring-fenced from other schemes of the Fund Management Entity; and bank accounts and securities accounts of each scheme are segregated and ring-fenced.

2.3.7. In this context, an agenda proposing to mandate manager and trustee of an AIF to ensure segregation and ring-fencing of assets and liabilities of each scheme of an AIF from that of other schemes of the AIF, was deliberated in the meeting of AIPAC held on July 26, 2022.

2.3.8. AIPAC recommended the proposal stating that the same would provide a comfort to investors and other stakeholders as their interests are protected from liabilities of other schemes of the AIF.

Proposal:

2.3.9. Taking into account the recommendations of AIPAC and internal deliberation, it is proposed that AIF Regulations may be suitably amended to specify that the Manager and the Trustee or Trustee company or the Board of Directors or Designated Partners of the AIF, based on the legal structure of the AIF, shall ensure that the assets and liabilities of each scheme of an AIF and bank accounts and securities accounts of each scheme are segregated and ring-fenced from other schemes of the AIF.

2.4. Review of regulatory provisions with regard to change in control of manager/sponsor and change in manager/sponsor of AIFs

2.4.1. Prior approval for change in manager/sponsor of AIFs

- a) In terms of Regulation 20(12) of AIF Regulations, AIFs are required to inform the Board in case of any change in the sponsor, manager or designated partners or any other material change from the information provided by the AIF at the time of application for registration.
- b) In terms of Regulation 20(13) of AIF Regulations, prior approval from the Board is required in case of change in control of AIF, sponsor or manager.
- c) It is seen from the regulatory provisions above that, AIFs are required to seek prior approval of the Board in case of change in control of the sponsor or manager, however, they are required to only inform the Board in case of change in sponsor or manager.
- d) It is pertinent to note that in both the aforesaid scenarios, the control of the manager/sponsor may be shifted to person(s)/entity(ies) different from the person(s)/entity(ies) at the time of granting registration to the AIF. Thus, it is imperative to ensure that such entities are eligible and satisfy the 'fit and proper' person criteria. Further, in case of change in the manager entity, it is necessary to ensure that the key investment team of the new manager satisfies the qualification and experience requirement specified in AIF Regulations.
- e) Therefore, it is necessary that change in manager/sponsor is not carried out without prior approval of SEBI.
- f) AIPAC in its meeting held on September 13, 2022 deliberated on the aforesaid proposal and recommended that the change in manager/sponsor should require prior approval of SEBI.

2.4.2. Levying fee for change in control of manager/sponsor or change in manager/sponsor of AIFs

- a) SEBI has received 3 applications in recent past, seeking approval for change in control of the manager and sponsor / change of the manager and sponsor entities, where the applicant AIFs were granted registration more than 4 years ago, but have not on-boarded any investor.
- b) In such cases, it is evident that a new entity/group intends to set up an AIF without getting fresh registration with SEBI, by way of replacing the manager and sponsor entities or taking controlling stake in the manager and sponsor of an existing, but inactive AIF.
- c) It is pertinent to note that the following fees are required to be paid for seeking registration as an AIF:

Category of AIF	Application fee (INR)	Registration fee (INR)
All sub-categories of Category I AIF (except Angel Fund)	1 lakh	5 lakh
Angel Fund	1 lakh	2 lakh
Category II AIF	1 lakh	10 lakh
Category III AIF	1 lakh	15 lakh

However, there is no fee required to be paid to SEBI in case of change in control of manager/sponsor or change in manager/sponsor.

- d) Therefore, such applicant AIFs as stated above, avoid paying any fees to SEBI and avoid following the existing regulatory requirement relating to PPMs before circulating the same to prospective investors. Thus, there is an incentive for entities to not take fresh registration with SEBI, and instead to find an inactive AIF and replace its manager and sponsor or take control of its manager and sponsor, which is not an appropriate practice.

- e) In this regard, it may be noted that in case of change in control of SEBI registered Portfolio Managers, Stock Exchanges, Depositories, Merchant Bankers, Debenture Trustees, Underwriters, Bankers to an Issue, Credit Rating Agencies, Registrar to an Issue and Share Transfer Agents, there is a requirement of seeking fresh registration, by paying requisite registration fee, within six months from the date of the prior approval. It is pertinent to mention that the requirement of payment of fee for registration is irrespective of whether the said intermediary is active or not.
- f) It is important to note that in case of AIFs, SEBI registers the Trust/Company/Limited Liability Partnership which is proposed to be set up as an AIF and does not register the manager/sponsor of the proposed AIF. However, sponsor is the entity which sets up the AIF and it is the manager who manages the AIF and takes all the decisions for the AIF. Therefore, change in control of manager/sponsor or change in the manager/sponsor of an AIF, should be subject to similar requirement of payment of fee to SEBI, as in case of change in control of aforementioned intermediaries.
- g) Accordingly, in case of change in control of manager/sponsor and in case of change in manager/sponsor of AIFs, a fee equivalent to the registration fee applicable to the respective category / sub-category of the AIF may be levied, with the condition that the cost paid towards such fee should not be passed on to the investors of the AIF in any manner whatsoever.
- h) AIPAC in its meeting held on September 13, 2022 also recommended that the fee as mentioned above may be levied in case of change in manager/sponsor and change in control of manager/sponsor.

Proposal:

2.4.3. Taking into account the recommendations of AIPAC and internal deliberation, the following is proposed:

- a) AIF Regulations may be suitably amended to provide that change in manager/sponsor shall require prior approval of SEBI.
- b) AIF Regulations may be suitably amended to facilitate levying fee in case of change in control of manager / sponsor and in case of change in manager / sponsor.

2.4.4. It is proposed that the following may be specified by way of circular:

- a) A fee equivalent to the registration fee applicable to the respective category / sub-category of the AIF, shall be levied in case of change in control of manager/sponsor and in case of change in manager/sponsor. The cost paid towards such fee should not be passed on to the investors of the AIF in any manner whatsoever.
- b) In case change in control of manager/change of manager and change in control of sponsor/change of sponsor of an AIF is proposed simultaneously, a fee equivalent to single registration fee shall be charged.
- c) The aforesaid fee shall not be levied in the following cases for change in sponsor or change in control of sponsor:
 - i) The manager is acquiring control in or replacing the sponsor and
 - ii) Exit of sponsor(s) in case of AIF having multiple sponsors.
- d) In case of the applications pending with SEBI for change in control of manager/sponsor or change in manager/sponsor, the requirement of fee shall be applicable only in those applications where none of the schemes of AIFs managed/sponsored by manager/sponsor have declared their First Close.

3. Proposal to the Board

3.1. The Board may consider and approve the following proposals to amend the AIF Regulations:

- a) To facilitate specifying the manner in which First Close of a scheme of an AIF may be declared;
- b) To facilitate specifying the manner in which the tenure of close ended schemes of AIFs may be calculated;
- c) To specify that assets and liabilities of each scheme of an AIF are to be segregated and ring-fenced from other schemes of the AIF; and
- d) To specify that change in manager/sponsor shall require prior approval of SEBI and to facilitate levying fee in case of change in control of manager/sponsor and in case of change in manager/sponsor.

The draft amendment to AIF Regulations and the draft notification for the proposed amendment are placed at **Annexure A** and **Annexure B** respectively.

3.2. The Board is requested to consider and approve the proposed amendment to SEBI (Alternative Investment Funds) Regulations, 2012 and authorize the Chairperson to make such necessary consequential or incidental changes to the SEBI (Alternative Investment Funds) Regulations, 2012 and take consequent steps, as may be deemed appropriate, to give effect to the decision.

Annexure A

Amendment to SEBI (Alternative Investment Funds) Regulations, 2012 shall be notified after following the due process.

Annexure B

Amendment to SEBI (Alternative Investment Funds) Regulations, 2012 shall be notified after following the due process.