

Amendment to SEBI (Alternative Investment Funds) Regulations, 2012

1. Objective

- 1.1 This Board Memorandum proposes to amend the SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”) to provide flexibility to managers of AIFs in constituting their key investment teams and taking investment decisions for the AIFs.

2. Issues for Consideration

A. Eligibility Criteria for the Key Investment Team of Manager of AIF

- 2.1 Regulation 4(g) of the AIF Regulations provides for the Manager of an AIF to mandatorily have a key investment team, with at least one key personnel having not less than 5 years of experience in advising or managing pools of capital or in fund or asset or wealth or portfolio management or in the business of buying, selling and dealing of securities or other financial assets and relevant professional qualification.
- 2.2 Since the AIF Regulations do not specify what constitutes ‘relevant professional qualification’, presently, for the purpose of granting registration to AIFs, SEBI ascertains whether the key personnel of the Manager’s investment team who is considered to qualify under Regulation 4(g), has a professional qualification such as Chartered Accountant, Company Secretary, CFA Charter from CFA Institute, Masters in Business Administration (MBA) or a Post Graduate Diploma in Management (PGDM) or its equivalent with a specialization in Finance. Further, Finance related subjects being part of the curriculum is considered sufficient if the MBA/PGDM are in other than Finance stream.
- 2.3 In this background, few applications were received where the critical investment team member whose experience in fund management or related business were relied upon (to solicit investors), did not have any of the qualifications that are considered relevant as stated in para 2.2 above. In this regard, SEBI has received requests to broaden the professional qualification criteria for the key personnel of investment team of Manager.
- 2.4 As evident from the Regulation 4(g) which states that the key investment team has adequate experience, AIF Regulations stresses on the experience of the investment team of Manager. However, academic knowledge of

financial accounts, portfolio analysis, cash flow analysis, understanding economic variables etc., is felt necessary to manage investments in an effective manner.

- 2.5 It is pertinent to mention that SEBI Regulations for other similar market intermediaries [SEBI (Portfolio Managers) Regulations and SEBI (Investment Advisors) Regulations] specifically define the professional qualification required for the key personnel.
- 2.6 To ensure consistency in considering relevant professional qualification, it is felt necessary to clarify what qualifies as 'relevant professional qualification' for the purpose of compliance with Regulation 4(g) of the AIF Regulations. Also, to provide flexibility to AIFs in fulfilling the criteria of key investment team i.e. professional qualification and experience, it is felt that the same may be fulfilled individually or collectively by investment team members.
- 2.7 Considering the above, with regard to constitution of key investment team of AIF, it may be provided as under:
 - (i) 'Relevant professional qualification' shall mean a professional qualification in finance, accountancy, business management, commerce, economics, capital market or banking from a university or an institution recognized by the Central Government or any State Government or a foreign university, or a CFA charter from the CFA institute or any other qualification as may be specified by the Board.
 - (ii) The eligibility criteria i.e. qualification and experience of the investment team, may be fulfilled individually or collectively by personnel of key investment team instead of the current requirement of both being fulfilled by the same individual.

B. Role of Manager and Investment Committee in investment decisions of AIFs

- 2.8 As defined in Regulation 2 (q) of the AIF Regulations, "manager" means any person or entity who is appointed by the AIF to manage its investments by whatever name called and may also be same as the sponsor of the AIF. While the AIF Regulations do not explicitly recognise the Manager to take investment decisions for AIFs, AIF Regulations also do not recognise an investment committee to take investment decisions for AIFs.

- 2.9 The SEBI Circular dated February 05, 2020 on 'Disclosure Standards for Alternative Investment Funds (AIFs)' provides for a template Private Placement Memorandum (PPM) in which information on various aspects of the AIF is to be provided, including information regarding constitution, role etc., of each governance body involved in the decision-making process of an AIF.
- 2.10 Post issuance of the aforesaid SEBI Circular, it is observed from the disclosures made in draft PPMs filed with SEBI by AIFs for launch of new schemes, that generally Managers prefer to constitute Investment Committee to be involved in the process of taking investment decisions for the AIF. The investment proposals are submitted to the Investment Committee by the Manager to provide its recommendations or for approval of investment decisions.
- 2.11 It is felt that constitution of Investment Committee to provide recommendations or advice to the Manager on the investment proposals, does not contradict the authority and responsibility vested in Manager under AIF Regulations to manage the investments of the AIF. Accordingly, as per current practice, applications for AIF registration and launch of new scheme are approved if the proposed Investment Committee comprising external members, only provides recommendations or advice to the Manager.
- 2.12 However, it is observed from certain PPMs that while the Manager may carry out all the necessary due diligence on an investment proposal and also do the needful to monitor and manage the AIF's investments, the decision to invest in a particular portfolio company vests with the Investment Committee set up by the Manager. Such Investment Committees may comprise internal and/or external members such as employees/directors/partners of the Manager, nominees of the Sponsor, employees of Group Companies of the Sponsor/ Manager, domain experts, investors or their nominees etc.
- 2.13 Based on the representations received from the AIF industry, it is felt that constitution of such Investment Committee by Managers for approving the investment decisions may be beneficial to the AIFs and their investors, viz.:
- a. Presence of investor(s) or Sponsor or their nominee(s) in an Investment Committee may serve to improve the due diligence carried out by the Manager, as they are stakeholders in the AIF's investments.

- b. Presence of functional resources from affiliate/group companies of the Manager (legal advisor, compliance advisor, financial advisor etc.) in the Investment Committee may be useful to ensure compliance with all applicable laws.
- c. Presence of domain experts in the committee may provide comfort to the investors regarding suitability of the investment decisions, as the investment team of the Manager may not have domain expertise in all industries/ sectors where the fund proposes to invest.

2.14 The regulatory framework for AIFs provides for minimal prudential norms and emphasizes on fair disclosure to investors while allowing managers to retain operational flexibility. As per AIF Regulations, the Manager of the AIF is required to have an experienced and qualified key investment team to manage its investments. However, there are merits in utilization of the expertise of one or more external individuals/members in evaluating investment proposals identified by the Manager and taking decisions thereon.

2.15 It is also important that, while an independent evaluation of investment proposals by Investment Committee may enhance the quality of decision making process, it is ensured that all such members who are involved in approving the investment decisions are also held accountable for such investment decisions.

2.16 Considering the above, it is felt necessary to clearly define the roles and responsibilities of the Manager and members of Investment Committee (by whatever name it may be called) who may be involved in the investment decisions of the AIF, as under:

- (i) The Manager shall be responsible for all investment decisions of the Alternative Investment Fund.
- (ii) The Manager of AIF may constitute an investment committee consisting of internal or external members to approve the investment decisions of the AIF, subject to the following:
 - a. The members of Investment Committee shall be equally responsible as the Manager for investment decisions of the Alternative Investment Fund.
 - b. The Manager and members of the Investment Committee shall jointly and severally ensure that the investments of the Alternative Investment Fund are in compliance with the

provisions of AIF Regulations, the terms of the placement memorandum, agreement made with the investor, any other fund documents, and any other applicable law.

- c. External members whose names are not disclosed in the placement memorandum or agreement made with the investor or any other fund documents at the time of on-boarding investors, shall be appointed to the Investment Committee only with the positive consent of at least seventy-five percent of the investors by value of their investment in the Alternative Investment Fund or scheme.

2.17 It is pertinent to mention that, as per clause (4) of Schedule VIII under FEM (Non-debt Instruments), Rules, 2019, "Investment made by an Investment Vehicle into an Indian entity shall be reckoned as indirect foreign investment for the investee Indian entity if the Sponsor or the Manager or the Investment Manager (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India." In this regard, while replying to SEBI's query regarding downstream investments by AIFs, RBI, vide letter dated August 22, 2017, had clarified that since investment decisions of an AIF are taken by its Manager and/or Sponsor, the downstream investment guidelines for AIFs were focussed on ownership and control of Manager and/or Sponsor.

2.18 For clarity on the applicability of clause (4) of Schedule VIII under FEM (Non-debt Instruments) Rules, 2019, on investment made by AIFs whose Investment Committee approves investment decisions and consists of external members who are not Indian resident citizens, SEBI vide letters dated September 07, 2020, has written to Government and RBI.

2.19 In the interim, SEBI would grant registration and take on record the PPMs for launching new schemes of those AIFs whose investment committees are empowered to take investment decisions and consist of external members who are Indian resident citizens.

2.20 Further, in case of applications of AIFs where investment committees are empowered to take investment decisions, comprise other than Indian resident citizens (i.e. foreigners or NRIs) as external members, such applications may be processed after receipt of clarification from Government and RBI.

2.21 A Circular shall be issued by SEBI in respect to interim measures stated in Para 2.19 and 2.20.

3. Proposal

3.1 Considering the recommendations at paragraph 2.7 and 2.16 above, it is proposed to amend Regulation 4 (g) and Regulation 20 of the AIF Regulations. The current relevant provisions of the AIF Regulations and the proposed changes to the same in a tabular format is placed at **Annexure A**. Draft amendment to SEBI (Alternative Investment Funds) Regulations, 2012 is placed at **Annexure B**.

3.2 The Board is requested to consider and approve the proposed amendment to SEBI (Alternative Investment Funds) Regulations, 2012 at Para 3.1 above and authorize the Chairman to make such necessary consequential or incidental changes to the SEBI (Alternative Investment Funds) Regulations, 2012 and take consequent steps including issuance of circulars, as may be deemed appropriate, to give effect to the decision.

Annexure A

This has been excised.

Annexure B

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