

Investment Funds: Monthly Digest

July 09, 2021

NEW STRATEGIES FOR AIFs: CHANGES TO AIF REGULATIONS

- AIFs allowed to employ fund-of-funds strategy along with direct investment strategy within the same fund;
- Key-managerial personnel to mandatorily follow the code of conduct provided in the AIF Regulations;
- Requirement to seek consent of 75% investors to appoint ex-officio external member to the ICOM, relaxed;
- SEBI approves framework for Accredited Investors; relaxes diversification and minimum investment norms for AIFs in case of Accredited Investors.

BACKGROUND

Alternative Investment Funds ("AIFs") in India are governed under the Securities and Exchange Board of India (Alternative Investment Regulations), 2012 ("AIF Regulations") and regulated by the Securities and Exchange Board of India ("SEBI"). Despite the halt of economic activities due to the Covid-19 Pandemic in the last year, the AIF industry has seen steady and tremendous growth and we have also seen SEBI proactively introducing new amendments to the AIF Regulations over the year.¹

SEBI had released the standard template of the Private Placement Memorandum ("PPM"), annual audit, disclosure, and benchmarking rules in early 2020² following which, various regulatory changes have taken place including changes concerning investment committees.³

SEBI has now released a circular, inter-alia allowing AIFs to invest in units of other AIFs ("Circular").⁴ SEBI in its recent board meeting has also discussed further amendments which could impact the AIF industry.⁵

This hotline will cover the background and our preliminary analysis on the Circular under Part-A, as well as the changes approved in the board meeting of SEBI held on June 29, 2021 ("Board Meeting") and our thoughts on the same under Part-B.

PART-A: SEBI CIRCULAR

1. Enabling combination of FoF and direct investment strategies in a single AIF

The Circular provides a framework for AIFs to invest in units of other AIFs alongside directly investing into investee companies. In other words, AIFs are now permitted to employ the fund-of-funds ("f-o-f") strategy along with the direct investment strategy within the same fund.

Regulations 15(1)(c) and 15(1)(d) of the AIF Regulations provide general restrictions on investments by AIFs. Regulation 15(1)(c) of the AIF Regulations applies to Category I and Category II AIFs and restricts such AIFs from investing more than 25% of their respective investible funds⁶ directly in an investee company *or* through investment in the units of other AIFs. Similarly, as per Regulation 15(1)(d) of the AIF Regulation, Category III AIFs cannot invest more than 10% of the investible funds directly in an investee company *or* through investment in the units of the other AIFs. The reading of these provisions suggested that the AIF would be required to choose between direct investments or investments through subscription to units of other AIFs. Further, the 2014 SEBI Circular⁷ ("2014 Circular") required AIFs investing into the units of other AIFs to ensure that they are 'fund of funds' as specified under the AIF Regulations.

The Circular now clarifies that AIFs ("Investing AIF") can simultaneously invest in investee companies as well as the units of other AIFs ("Investee AIF") provided the information about such combination of strategies is conspicuously disclosed in the PPM of the Investing AIF as specified in the Circular. The Circular also partially modifies the 2014 SEBI Circular.

Existing Investing AIFs are also permitted to take advantage of the Circular subject to the aforesaid PPM disclosures and also with prior consent of at least two-thirds of the total unitholders of the Investing AIF by value (as it would be considered a material alteration to the investment strategy of the firm).⁸

In light of the Circular, a 2013 SEBI Circular⁹ allowing Category III AIFs to undertake leverage not exceeding two times the value of the net asset value ("NAV") of the portfolio investment held has also been modified. As per the Circular, any Category III AIF investing in the units of any Investee AIF can undertake leverage after deducting the value of investments in units of the Investee AIFs from the NAV of the total portfolio investment held by such AIF.

The Circular comes after similar positions were clarified with respect to AIFs set up in the International Finances Services Centre in the Gujarat International Finance Tech-City ("GIFT City") as per the circular issued by the

Research Papers

Mergers & Acquisitions

July 11, 2025

New Age of Franchising

June 20, 2025

Life Sciences 2025

June 11, 2025

Research Articles

2025 Watchlist: Life Sciences Sector India

April 04, 2025

Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

Audio

CCI's Deal Value Test

February 22, 2025

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Reimagining CSR: From Grant Giving to Blended Finance & Outcome Based Funding

June 16, 2025

Courts vs Bankruptcy code: The

Analysis

The Circular provides much-needed clarity for AIFs who engage in employing f-o-f strategy along with the direct investment strategy. Combination of the two different allocation strategies within the same AIF vehicle could allow better means for diversification, deal structuring and allowing a ‘multi-manager model’, in effect.

The documentation for an AIF employing both the strategies would need to be carefully crafted in order to balance the fund terms pertaining to operations for direct investment vehicle and a f-o-f. For example, while drawdowns, investments, distributions and giveback obligations by such Investing AIF for direct investments will be controlled by its own Investment Manager (“IM”), such terms for the Investee AIFs will need to be met on a back-to-back basis.

2. Applicability of Code of Conduct on key management personnel

The AIF Regulations provide that the key management personnel (“KMPs”) are required to abide by the Code of Conduct provided in the fourth schedule of the AIF Regulations. ¹¹ For this purpose, the Circular clarifies who would be a KMP:

- members of the key investment team of the IM, as disclosed in the PPM of the AIF;
- employees who are involved in decision making on behalf of the AIF, including members of the senior management team at the level of Managing Director, Chief Executive Officer, Chief Investment Officer, Whole Time Directors, or such equivalent role or position;
- any other person whom the AIF (through the trustee, board of directors, or designated partners, as the case may be) or IM may declare as a KMP.

The names of such above-mentioned KMPs are required to be disclosed in the PPM, and any change thereof has to be notified to the investors and SEBI.

Analysis

The Circular has imposed a new intimation requirement. AIFs were not required to intimate SEBI upon any change in the investment team, as it consists of employees who may be subject to frequent change in the ordinary course of business (unlike the founders / key persons/investment committee members) whose departure could impact the fate of the AIF. It may have been less onerous (and more practicable) to require intimation to SEBI by the IM if the KMP(s) who meet(s) the SEBI criteria of qualification and experience ¹² is being replaced by any other persons due to their departure.

3. Clarifications concerning Investment Committee

SEBI vide its notification dated October 19, 2020 (“2020 Notification”) had statutorily provided for the constitution of an Investment Committee (“ICOM”) by the IM. ¹³ It also provided that the members of the ICOM would be severally and jointly liable for the investment decisions and compliance of the AIF Regulations as well as the governing documents of the AIF. As the 2020 Notification tried to fasten responsibility for legal compliances on the ICOM which is primarily responsible for the commercial decision of the AIF while also holding the IM liable, the AIF industry provided a negative feedback on the notification. To address the concerns of the stakeholders, SEBI released another notification in January 2021 (“Amendment Notification”). ¹⁴ This Amendment Notification introduced a mechanism to obtain a waiver from the requirements and responsibilities outlined in the 2020 Notification. The waiver mechanism allows the AIFs in which each investor other than the AIF IM, sponsor, employees, or directors of the AIF or employees or directors of the AIF IM, has committed to invest not less than INR 70 crore and has furnished a waiver to the AIF in respect of compliance with the said clauses, in the manner as specified by SEBI. We have covered this issue in detail [here](#) and [here](#).

In its current Circular, SEBI has prescribed a format to seek such waivers from compliance by the ICOM of the AIFs. Further, the Circular has relaxed the requirement of seeking the consent of at least 75% of the investors by the value of their investment in the AIF or a scheme for appointment of ex-officio external members to the ICOM of the AIF. Ex-officio external members mean those who represent the sponsor, sponsor group, manager group, or investors in their official capacity. This is an important clarification because it provides some guidance with respect to the meaning of the term ‘external’ while designing the constitution of investment committees. On this note, unfortunately, pursuant to the 2020 Notification, no clarification has yet been received from the Reserve Bank of India regarding the applicability of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 on AIFs which have decision making ICOMs with external members who are not Indian resident citizens. The critical issue is that SEBI in its 2020 Notification did not refer to ICOMs where a *majority* of the decision-making members of the ICOM are not Indian resident citizens, thereby creating a roadblock for AIF applicants whose ICOMs have even a single member who is not an Indian resident citizen.

PART B: HIGHLIGHTS OF THE BOARD MEETING

Introduction of Framework for Accredited Investors in securities market

In the Board Meeting, SEBI has approved the proposal to introduce a framework for Accredited Investors (“AIs”) in the Indian securities market. AIs have been referred to as a class of investors who could be considered to be well informed or advised about the investment products. These AIs can be individual investors, HUFs, family trusts, sole proprietorships, partnerships, trusts, and body corporates. The financial parameters for each category to qualify as an AI shall be notified by SEBI.

The proposal also provides for the establishment of Accreditation Agencies (“AAs”). AAs will be the primary authority to provide accreditation status and issue Accreditation Certificate to the AIs. These AAs can be eligible subsidiaries of the depositories and specified stock exchanges and may include any other institutions recognised as an AA.

Further, the proposed framework provides the modalities of getting the accredited as well the benefits linked with

such accreditation. These include:

1. **Relaxed minimum commitment/investment criteria:** The AIs will be permitted to invest in investment products an amount lesser than the prescribed threshold of minimum investment. This includes the minimum investment criteria of Rs. 1 crore for investment in AIFs under the AIF Regulations,¹⁵
2. **Relaxation from regulatory requirements:** In an AIF with only AIs where each AI invests a minimum amount of Rs. 70 crores could be exempt from following the portfolio diversification norms, conditions for the launch of schemes, and extension of tenure of AIF.

Analysis

The Alternative Investment Policy Advisory Committee ("AIPAC") in its second report providing recommendations to SEBI to make changes to the AIF regime in India had proposed to widen the pool of investors eligible to invest in an AIF.¹⁶ To identify such sophisticated investors who could be eligible to invest in the AIF, it was proposed that India like other jurisdictions prepares a framework to identify AIs.

It was realised that allowing a separate category of investors would enable moving towards a more regulated exchange framework. A more regulated exchange framework enhances the confidence of foreign investors in funds set up in India. Recently, the AIPAC in its fourth report had again suggested the adoption of an AI Framework specifically for investment in Angel Funds.¹⁷

In other jurisdictions, the concept of AI is also used to define marketing rules. In India, the marketing of AIFs is regulated under the AIF Regulations to the extent of a prohibition on public offering of units of the AIF. The light-touch marketing restrictions on AIFs in India contributes greatly to the attractive nature of AIFs. The Board Meeting minutes do not indicate the introduction of any additional marketing restrictions in the context of AIFs other than with respect to allowing AIs to invest in AIFs with lower ticket size than required for others, even though some changes have been discussed with respect to investment advisers ("IA") who have AIs as clients under the SEBI (Investment Advisor) Regulations, 2013. These changes include flexibility to determine the limits and modes of paying fees to the IAs through bilaterally negotiated contractual terms.¹⁸

It is not clear whether the proposed framework as envisaged by SEBI allows the AIs to invest in Angel Funds. Under the AIF regulations, only Angel Investors are eligible to invest in Angel Funds.¹⁹ Angel Investors for this purpose can be either individual investors or body corporates.²⁰ This could imply that trust and general partnerships cannot invest in Angel Funds. This restriction narrows down the pool of investors which can invest in such funds, specifically set up to invest in pre-seed and seed investments in start-ups.

– Srishti Chhabra & Nandini Pathak

You can direct your queries or comments to the authors

¹ Data relating to activities of Alternative Investment Funds (AIFs) available at <https://www.sebi.gov.in/statistics/1392982252002.html>.

² SEBI circular no. SEBI/HO/IMD-I/DF6/P/CIR/2021/584 dated June 25, 2021 available at <https://legalitysimplified.com/wp-content/uploads/2021/06/1624628288650.pdf>

³ SEBI notification dated October 19, 2020 available at https://www.sebi.gov.in/legal/regulations/oct-2020/securities-and-exchange-board-of-india-alternative-investment-funds-amendment-regulations-2020-_47914.html and SEBI Circular dated January 08, 2021, available at https://www.sebi.gov.in/legal/regulations/jan-2021/securities-and-exchange-board-of-india-alternative-investment-funds-amendment-regulations-2021_48708.html

⁴ SEBI circular no. SEBI/HO/IMD-I/DF6/P/CIR/2021/584 dated June 25, 2021 available at <https://legalitysimplified.com/wp-content/uploads/2021/06/1624628288650.pdf>

⁵ Minutes of the meeting available at https://www.sebi.gov.in/media/press-releases/jun-2021/sebi-board-meeting_50771.html.

⁶ Regulation 2(p) of the AIF Regulations defines Investible Funds as the corpus of the Alternative Investment Fund net of estimated expenditure for administration and management of the fund

⁷ SEBI Circular no. CIR/IMD/DF/14/2014 dated June 19, 2014 available at https://www.sebi.gov.in/legal/circulars/jun-2014/guidelines-on-disclosures-reporting-and-clarifications-under-aif-regulations_27118.html.

⁸ Regulation 9(2) of the SEBI regulations

⁹ SEBI Circular no. CIR/IMD/DF/10/2013 dated July 29, 2013 available at https://www.sebi.gov.in/sebi_data/attachdocs/1375094611151.pdf

¹⁰ IFSCA Circular no. F. No. 81/IFSCA/AIFs/2020-21 dated December 9, 2020 available at <https://ifsc.gov.in/Document/Legal/alternative-investment-funds-in-ifsc09122020071200.pdf>

¹¹ Regulation 20(1) of the AIF Regulations

¹² Regulation 4(g) of the AIF Regulations

¹³ SEBI notification dated October 19, 2020 available at https://www.sebi.gov.in/legal/regulations/oct-2020/securities-and-exchange-board-of-india-alternative-investment-funds-amendment-regulations-2020-_47914.html

¹⁴ SEBI Circular dated January 08, 2021, available at https://www.sebi.gov.in/legal/regulations/jan-2021/securities-and-exchange-board-of-india-alternative-investment-funds-amendment-regulations-2021_48708.html

¹⁵ Regulation 10 of the AIF Regulations

¹⁶ Chapter 4, pg. 63 of the AIPAC Report II available at <https://ivca.in/wp-content/uploads/2018/08/AIPAC-2.pdf>.

¹⁷ Chapter 8 of AIPAC Report IV available at <https://ivca.in/wp-content/uploads/2018/08/AIPAC-4.pdf>.

¹⁸ Minutes of the meeting available at https://www.sebi.gov.in/media/press-releases/jun-2021/sebi-board-meeting_50771.html.

¹⁹ Regulation 19 of the AIF Regulations

²⁰ Regulation 19 (A) of the AIF Regulations

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.