

# Investment Funds: Monthly Digest

January 07, 2022

## 2021: A YEAR IN REVIEW FOR ALTERNATIVE INVESTMENT FUNDS IN INDIA

In an attempt to streamline fund-raising activities and provide robust investor protection framework pertaining to the Alternative Investment Funds (“AIFs”), the Securities and Exchange Board of India (“SEBI”) in the past year has introduced a slew of amendments in SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”). SEBI, *inter alia*, has provided for certain conditions related to decision making powers of Investment Committee, introduction of a new concept of ‘accredited investors’ and certain exemptions related to the same, streamlining the investment restrictions applicable on Category I AIFs and provision of filing the private placement memorandum (“PPM”) by a Merchant Banker. In this edition of the digest, we have discussed the major amendments introduced in the AIF Regulations in the year 2021, below.

### FIRST AMENDMENT

#### Exemption to AIFs on investment committee

SEBI, vide its notification dated October 19, 2020<sup>1</sup> had provided guidelines for the constitution of the Investment Committee (“ICOM”) by the AIF manager. The notification also provided that members of ICOM, along with the AIF manager, shall be liable for the investment decisions of the AIF. The members of the ICOM were obliged to ensure that investments by AIF are in compliance with the AIF Regulations. However, on January 08, 2021<sup>2</sup>, SEBI amended Regulation 20(6) of AIF Regulations to provide for a waiver mechanism for certain AIFs from the requirement of being (i) equally responsible as the AIF manager for investment decisions of the AIFs and (ii) jointly and severally responsible along with the AIF manager to ensure that the investments of the AIF are in compliance with the AIF Regulations, the terms of the PPM of the AIF, agreements made with the investors, any other fund documents and any other applicable law.

The act of SEBI striking a middle ground with regard to the joint liabilities of the members of the ICOM and the AIF manager managed to provide some comfort to the AIF managers, especially those with large institutional investors. Notably, vide the aforementioned amendments SEBI encouraged qualified consultants to be a part of ICOM thereby further improving the overall governance of the AIF. However, SEBI has been putting on hold all such applications for registration of AIF where the proposed ICOM includes an external member who is not a ‘resident Indian citizen’ pending clarity from Reserve Bank of India (“RBI”) on the applicability of foreign exchange control laws on such AIF manager. For a detailed analysis of such amendments, please refer to our monthly digest for January 2021 which is available [here](#).

### SECOND AMENDMENT

#### Simultaneous investment in investee companies and other AIFs

SEBI vide its amendments on May 05, 2021<sup>3</sup> permitted AIFs to invest in an investee company, directly or through other AIFs, subject to diversification limits of (a) 25% (of investible funds) for Category I and II AIFs; and (b) 10% (of investible funds) of Category III AIFs. The amendment allows an AIF to make investments into the portfolio companies directly and also act as fund of funds at the same time. While providing for such relaxations, SEBI has mandated that an AIF investing in other AIFs is not further permitted to have an AIF as its investor. In this regard, AIFs which is having another AIF as an investor will be required to seek a confirmation from the investor AIFs that such AIF does not have another AIF as its investor.

#### Definition of ‘start-up’

Venture Capital Fund (“VCF”), under the AIF Regulations, is set up as a sub-category of a Category I AIF and includes an angel fund (“Angel Fund”). Even though the AIF Regulations allow Angel Funds to invest in ‘Venture Capital Undertakings (“VCUs”)’ or ‘start-ups’, the AIF Regulations do not define the term ‘start-up’. To further elaborate, under the extant AIF Regulations, Angel Funds have been permitted to invest in VCUs, which, *inter alia*, comply with the criteria regarding the age of the VCU / start-up, issued by the Department for Promotion of Industry and Internal Trade (“DPIIT”) vide Notification dated February 17, 2016 (“DPIIT Notification”), or such other policy made in this regard. In view of the said, SEBI vide its amendment provided a definition of ‘start-up’ in the AIF Regulations thereby eliminating any uncertainty around the scope of the term and helping to bring it in parity with the said term as defined by other regulators. In other words, such a measure ensured that the definition of ‘start-up’ is harmonised with the definition provided by the DPIIT’s notification dated February 19, 2019.<sup>4</sup>

#### Removal of restricted activities

## Research Papers

### The Tour d’Horizon of Data Law Implications of Digital Twins

May 29, 2025

### Global Capability Centers

May 27, 2025

### Fintech

May 05, 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

### Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

April 01, 2025

SEBI has also removed the list of the restricted activities<sup>5</sup> from the definition of VCU provided under Regulation 2(1) (aa) of the AIF Regulations thereby not only boosting investments in the start-up space but also making Category I AIFs all the more lucrative for managers and investors.

### Code of Conduct

SEBI has also provided further clarity on the responsibilities of the AIF manager and the members of the ICOM. It has prescribed a Code of Conduct for AIFs, trustee, directors of the trustee/designated partners/directors of the AIF, manager, ICOM and key management personnel of the AIFs.

### Investment Committee

Further, in order to provide clarity on the scope of responsibilities casted on the ICOM, SEBI has stipulated that the ICOM members shall ensure that their decisions are also in compliance with the policies and procedures of the AIF, provided that a waiver can be obtained in this regard by AIFs where each investor has a capital commitment of at least INR 70 crores to each such AIF. ICOM members may not be jointly liable with AIF managers due to the amendments; however, SEBI seems to have retained regulatory authority over such members. The above changes reflected the market regulators' continual approach to strike a balance between accountability of the AIF managers towards the investors and the flexibility such managers would need to effectively run their operations. Moreover, these measures have resulted in increased investor protection by ensuring transparency and accountability of the concerned personnel. For a detailed analysis of such amendments, please refer to our funds hotline in the month of May, 2021 which is available [here](#).

### Streamlining Reporting Requirements

Subsequent to consultation with various stakeholders and considering the recommendations of the Alternative Investment Policy Advisory Committee, SEBI vide its circular dated April 7, 2021<sup>6</sup> streamlined the stringent reporting requirements applicable to an AIF. All the AIFs are required to submit the reports on their activity to SEBI on a quarterly basis, within 10 calendar days from the end of each quarter, with Category III AIFs also being required to submit their reports on leverage undertaken, on a quarterly basis. Moreover, any changes made to the PPM or any other fund document shall be intimated to the investor and SEBI in a consolidated format, within a month from the end of each financial year (in lieu of previously stipulated half-yearly basis). Such moderations should prove to be instrumental in assisting the AIF managers to remain in compliance with the applicable laws without diluting the investor protection objective of SEBI.

## THIRD AMENDMENT

### Accredited Investor

SEBI notified the (Alternative Investment Funds) (Third Amendment) Regulations, 2021 on August 03, 2021.<sup>7</sup> Vide such amendments, SEBI introduced a concept of an Accredited Investor ("**AI**") which is any person who is granted a certificate of accreditation by an accreditation agency. An Accreditation Agency for this purpose can be a subsidiary of a recognised stock exchange or a subsidiary of a depository, or any other entity as may be specified by SEBI. SEBI has also provided certain financial parameters which need to be satisfied to grant the AI status to resident Indians. Further, any AIF or any scheme of an AIF in which each investor (other than the Investment Manager, Sponsor, employees or directors of the AIF or employees or directors of the AIF manager) is an AI and invests not less than INR 70 crores would be classified as a "large value fund for accredited investors" ("**Large Value Funds**").

Various relaxations have given to such Large Value Funds such as (i) permission to the AIs in such funds to invest less than the minimum capital commitment of INR 1 crore as prescribed in the AIF Regulations; (ii) relaxed timelines in terms of filing of the PPM with SEBI; (iii) permission to extend the tenure of the fund beyond two years; and (iv) relaxation from following the diversification norms as applicable to different categories of AIFs under the AIF Regulations. Such amendments should be viewed as a step forward towards more relaxed regulatory environments for sophisticated investors which in turn will bring India at par with other global financial hubs. For a detailed analysis of such amendments, please refer to our funds hotline in the month of August, 2021 which is available [here](#).

## FOURTH AMENDMENT

### Investment Restrictions on VCF removed

Under the AIF Regulations, Category I AIFs under the VCF sub-category were mandatorily required to invest at least two-thirds (66.67%) of the total investable funds in (i) unlisted equity shares or equity-linked instruments ("**Equity**") of a VCU or (ii) in companies listed or proposed to be listed on a Small and Medium Enterprise exchange or Small and Medium Enterprise segment of an exchange. SEBI vide its amendments to the AIF Regulations dated August 13, 2021<sup>8</sup> has increased the aforesaid limit to three-fourth (75%) of the total investable funds in the abovementioned avenues. In addition to the above, SEBI decided to do away with other investment restrictions applicable on the residual portion of the investable of the VCF. Such removal of the investment restrictions will provide more autonomy to the AIF manager to invest in entities which could maximize the overall returns of the AIF instead of being subject to a more restricted investment allocation criteria.

### Issue of partly-paid up units

SEBI has also now allowed AIFs to issue partly-paid up units to investors to represent the portion of the committed capital invested thereby providing more clarity from an accounting perspective to the AIFs.

### Filing of the PPM through Merchant Bankers

SEBI has further mandated that AIFs shall be required to file the PPM and any subsequent changes to the PPM through registered Merchant Bankers. Vide such amendments, SEBI has intended to ensure that a third party verifies the contents of the PPM before it is filed with SEBI and circulated to the investors. However, such a requirement could lead to further delay in launching of AIFs. Further, an additional requirement of getting the PPM verified by a third party would increase the costs and would lead to additional documentation for availing the services of the Merchant Bankers. For a detailed analysis of such amendments, please refer to our funds hotline in the month of August, 2021 which is available [here](#).

## FIFTH AMENDMENT

### Co-investment

SEBI vide its amendments to the AIF Regulations dated November 09, 2021<sup>9</sup> introduced the definition of co-investment. Under regulation 2(fa) of the AIF Regulations, co-investment has now been defined as investment made by Manager or Sponsor or investor of Category I and II AIF in investee companies where such co-investment by investor of AIF is required to be made through Co-investment Portfolio Manager (“CPM”) license which is an additional registration that the AIF manager is required to seek under the SEBI (Portfolio Managers) Regulations, 2020 (“PMS Regulations”). The amendments go on to prescribe that the terms of investment and exit of such co-investments to be identical to that of the AIF. In addition to the aforesaid, the amendments also provides that the CPM shall only provide services to the investors of the AIF; *however* they may provide services to investors from any other Category I or Category II AIFs, provided that they are managed by the CPM and are also sponsored by the same sponsor. In this regard, SEBI has also amended PMS Regulations to facilitate co-investment by investors of AIF through portfolio management route. The CPM is also required to ensure that 100% of the assets under their management are invested in unlisted securities. Notably, SEBI has exempted such CPMs from certain requirements under PMS Regulations such as minimum investment amount, minimum net-worth, appointment of custodian etc. For a detailed analysis of such amendments, please refer to our funds monthly digest for November, 2021 which is available [here](#).

### Investor Charter

SEBI vide its circular dated December 10, 2021 has mandated the disclosure of an investor charter for AIFs with a view to provide relevant information to investors about the various activities pertaining to AIFs. Accordingly, it has mandated all AIFs to bring the investor charter to the notice of investors through PPM in case of new schemes and for existing schemes, as a one-time measure, by disclosing it to the investors on their registered e-mail.

Additionally, in order to bring about further transparency in the investor grievance redressal mechanism, SEBI has decided that data on investor complaints received against AIFs and each of their schemes and redressal status thereof shall be disclosed annually by all AIFs.

Further AIFs shall maintain data on investor complaints, which shall be compiled latest within 7 days from the end of quarter.

The above changes have been brought to provided as a measure of investor education and to bring in more transparency with respect to the disclosures to be made by the AIF.

## SEBI BOARD MEETING – DECEMBER, 2021

SEBI in its board meeting dated December 28, 2021<sup>10</sup> has also approved certain amendments in the AIF Regulations effectively paving way for a new category of AIFs i.e. Special Situation Funds, as a sub-category under Category I AIF, which shall invest only in stressed assets such as (i) stressed loans available for acquisition in terms of RBI (Transfer of Loan Exposures) Directions, 2021 or as part of a resolution plan approved under Insolvency and Bankruptcy Code, 2016; (ii) security receipts issued by Asset Reconstruction Companies; (iii) securities of companies in distress; (iv) any other asset/security as may be prescribed by SEBI from time to time.

In this regard, SEBI has provided for certain exemptions in the form that the Special Situation Funds (“SSFs”) will be exempted from investment concentration norm in a single investee company and investing their investible funds in unlisted or listed securities of the investee company. Further, it has been proposed that the minimum investment by an investor in such SSF should be INR 10 crore and INR 5 crore in case of an AI with a requirement of minimum corpus of INR 100 crore. Moreover, initial and continuous due diligence requirements mandated by RBI for Asset Reconstruction Company investors shall also be applicable to SSFs while acquiring stressed loans in terms of RBI (Transfer of Loan Exposures) Directions, 2021.

## GIFT CITY

In addition to the amendments in the AIF Regulations, SEBI in its attempt to incentivise Gujarat International Finance Tec-City (“GIFT City”) which is India’s first International Finances Services Centre (“IFSC”) as an investment destination has released a circular<sup>11</sup> allowing one-time off-market transfer of securities by a Foreign Portfolio Investor (“FPIs”) to the IFSC. The circular allows relocation of foreign funds (set-up as FPIs) to set up Category-III AIFs in IFSC. Subsequently, the International Financial Services Authority (“IFSCA”) has released a circular providing that the requirement of continuing interest by the manager or sponsor provided in the Operating Guidelines for AIFs in IFSC shall be voluntary in case of relocation of offshore funds to IFSC.<sup>12</sup> Alongside these regulatory changes, various changes have been brought to the tax regime to facilitate relocation of offshore funds to the GIFT City in a tax neutral manner. For a detailed analysis of such amendments please refer to our GIFT City express hotline in the month of September, 2021 which is available [here](#).

Further, in a move that seeks to both incentivise as well as expedite the setting up of AIFs by Indian managers in the GIFT City, the RBI on May 12, 2021 has issued a circular permitting sponsor contribution from an Indian party sponsor to the funds set up in overseas jurisdictions, including IFSC AIFs.<sup>13</sup> For a detailed analysis of such amendments please refer to our GIFT City express hotline in the month of May, 2021 which is available [here](#).

## CONCLUSION

Noteworthy herein is that SEBI vide the introduction of the aforementioned amendments have brought in significant reforms in the AIF industry. While certain amendments in the AIF Regulations such as permission of making simultaneous investment in other AIFs, removal of restrictions from the ambit of VCU, increase of investment limits for VCF, exemptions to members of ICOM, allowing issuance of partly paid units, introduction of AI and large value fund for AI, introduction of SSFs as a new sub-category under Category I AIFs, allowing relocation of funds, permitting sponsor contribution by Indian parties in GIFT City have been largely welcomed by the AIF managers and investors alike, other amendments such as not limiting the statutory liability of ICOM members only for investment decisions

(and not for ensuring compliance), requirement of filing the PPM of the fund through a Merchant Banker, increasing the compliance burden on the AIF managers in terms of providing co-investment opportunities i.e. to register as portfolio managers with SEBI in order to offer co-investment opportunities to the AIF's investors have received a lukewarm response of the AIF managers.

Such amendments have instead provided for increased regulatory compliances, in a framework which originated as light-touch but is increasingly becoming compliance intensive. However, from a SEBI perspective such amendments intend to ensure further transparency in the operations of the AIF and try to ensure that the fiduciary obligations of the AIF managers towards the investors are not compromised with.

– Dibya Behera, Shivam Ahuja & Parul Jain

You can direct your queries or comments to the authors

---

<sup>1</sup> SEBI (Alternative Investment Funds) (Amendment) Regulations, 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](https://www.sebi.gov.in/legal/regulations/oct-2020/securities-and-exchange-board-of-india-alternative-investment-funds-amendment-regulations-2020-_47914.html).

<sup>2</sup> 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](https://www.sebi.gov.in/legal/regulations/jan-2021/securities-and-exchange-board-of-india-alternative-investment-funds-amendment-regulations-2021_48708.html)

<sup>3</sup> SEBI (Alternative Investment Funds) (Second Amendment) Regulations, 2021, *available at*

[https://www.sebi.gov.in/legal/regulations/may-2021/securities-and-exchange-board-of-india-alternative-investment-funds-second-amendment-regulations-2021\\_50089.html](https://www.sebi.gov.in/legal/regulations/may-2021/securities-and-exchange-board-of-india-alternative-investment-funds-second-amendment-regulations-2021_50089.html)

<sup>4</sup> Department for Promotion of Industry and Internal Trade Notification dated February 19, 2019, *available at*

<https://www.startupindia.gov.in/content/dam/invest-india/Templates/public/198117.pdf>.

<sup>5</sup> Prior to the amendment, definition of "venture capital undertaking" read as under:

"venture capital undertaking" means a domestic company: (i) which is not listed on a recognised stock exchange in India at the time of making investment; and (ii) which is engaged in the business for providing services, production or manufacture of article or things and does not include following activities or sectors:

- (1) non - banking financial companies;
- (2) gold financing;
- (3) activities not permitted under industrial policy of Government of India;
- (4) any other activity which may be specified by the Board in consultation with Government of India from time to time

<sup>6</sup> SEBI Circular on Regulatory Reporting by AIFs, *available at*

[https://www.sebi.gov.in/legal/circulars/apr-2021/circular-on-regulatory-reporting-by-aifs\\_49788.html](https://www.sebi.gov.in/legal/circulars/apr-2021/circular-on-regulatory-reporting-by-aifs_49788.html).

<sup>7</sup> SEBI (Alternative Investment Funds) (Third Amendment) Regulations, 2021, *available at*

[https://www.sebi.gov.in/legal/regulations/aug-2021/securities-and-exchange-board-of-india-alternative-investment-funds-third-amendment-regulations-2021\\_51670.html](https://www.sebi.gov.in/legal/regulations/aug-2021/securities-and-exchange-board-of-india-alternative-investment-funds-third-amendment-regulations-2021_51670.html).

<sup>8</sup> SEBI (Alternative Investment Funds) (Fourth Amendment) Regulations, 2021, *available at*

[https://www.sebi.gov.in/legal/regulations/aug-2021/securities-and-exchange-board-of-india-alternative-investment-funds-fourth-amendment-regulations-2021\\_51911.html](https://www.sebi.gov.in/legal/regulations/aug-2021/securities-and-exchange-board-of-india-alternative-investment-funds-fourth-amendment-regulations-2021_51911.html).

<sup>9</sup> SEBI (Alternative Investment Funds) (Fifth Amendment) Regulations, 2021, *available at*

[https://www.sebi.gov.in/legal/regulations/nov-2021/securities-and-exchange-board-of-india-alternative-investment-funds-fifth-amendment-regulations-2021\\_53830.html](https://www.sebi.gov.in/legal/regulations/nov-2021/securities-and-exchange-board-of-india-alternative-investment-funds-fifth-amendment-regulations-2021_53830.html).

<sup>10</sup> SEBI Board Meeting, *available at*

[https://www.sebi.gov.in/media/press-releases/dec-2021/sebi-board-meeting\\_55018.html](https://www.sebi.gov.in/media/press-releases/dec-2021/sebi-board-meeting_55018.html).

<sup>11</sup> SEBI circular dated June 01, 2021, *available at*

[https://www.sebi.gov.in/legal/circulars/jun-2021/off-market-transfer-of-securities-by-fpi\\_50380.html](https://www.sebi.gov.in/legal/circulars/jun-2021/off-market-transfer-of-securities-by-fpi_50380.html)

<sup>12</sup> IFSCA circular dated June 25, 2021, *available at*

<https://www.ifsc.gov.in/Document/Legal/circular-for-sponsor-contribution-and-mutual-fund-investment-by-aif-in-ifsc28062021101503.pdf>.

<sup>13</sup> RBI/2021-22/38; A.P.(DIR Series) Circular No. 04, *available at*

[https://rbi.org.in/scripts/BS\\_CircularIndexDisplay.aspx?id=12092](https://rbi.org.in/scripts/BS_CircularIndexDisplay.aspx?id=12092).

---

## 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.