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-IFSCA Legal & Regulatory Roundup for 2024-25-

ANNUAL ROUND-UP FOR FY 2024 – 25 FOR ALTERNATIVE INVESTMENT FUNDS

The Financial Year 2024-25 had witnessed significant regulatory developments with respect to Alternative Investment Funds ("**AIF**").

AT ICUL, we bring to you a recap of all the key changes and updates from the last financial year under the SEBI (Alternative Investment Funds) Regulations, 2012 ("**AIF Regulations**") with respect to AIF legal and regulatory landscape.

SEBI UPDATES

1. Management of unliquidated investments by AIFs

One of the primary focuses of SEBI this year was to streamline the manner in which SEBI-registered AIFs manage and dispose of their investments, especially after the end of their tenure. In this regard, the following changes have been introduced by SEBI:

(a) Introduction of Dissolution Period

SEBI had in June' 2023 introduced the Liquidation Scheme (which was discontinued from April 24, 2024 onwards) to allow AIFs to operate during the extended period after the end of the liquidation period. However, to further ease the process, SEBI *vide* the SEBI (Alternative Investment Funds) (Second Amendment) Regulations, 2024 along with its circular dated April 26, 2024[1], has introduced the concept of 'Dissolution Period', which is the period following the expiry of the liquidation period of an AIF scheme, to liquidate the unliquidated investments of the concerned scheme of the AIF.

Under the said mechanism, an option is provided to the Investment Manager to dispose off the unliquidated investments in a scheme which were not sold due to lack of liquidity through *in specie* distribution or enter the Dissolution Period, after obtaining approval of at least seventy-five percent of the investors by value of their investments in the scheme of AIF.

SEBI has also prescribed the following to be disclosed while seeking the consent of the investors: (i) proposed tenure of the Dissolution Period along with details of unliquidated investment, value recognition of the unliquidated investments for reporting to performance benchmarking agencies, etc.

(ii) an indicative range of bid value, along with the valuation of the unliquidated investments carried out by two independent valuers.

Further, before seeking investor consent the Investment Manager shall be required to arrange a bid for a minimum of 25% of the value of its unliquidated investments. The bid shall be arranged from multiple bidders and for units representing consolidated value of all unliquidated investments of the scheme's investment portfolio.

Additionally, if the Investment Manager is able to successfully arrange the aforementioned bid, it shall be required to offer an exit option to the dissenting investors out of the bid arranged. After exercising the exit option by the dissenting investors, any unsubscribed portion of the bid may be used to provide pro-rata exit to non-dissenting investors should they opt for the same.

SEBI has also provided flexibility to the Investment Manager in case it is not able to obtain requisite bids for unliquidated investments. SEBI has provided that in such cases also the Investment Manager may also extend the tenure of the scheme into the Dissolution Period if it obtains the consent of at least 75% of the investors by value of their investment in the scheme.

SEBI has also provided certain checks in the process to ensure that the interests of the investors are kept paramount. These checks include:
(i) If the bidder or its related parties are investors in the scheme, then such investors cannot be provided an exit from the scheme out of the bid.
(ii) Before the expiry of the liquidation period, the Investment Manager must intimate SEBI about obtaining investor consent for entering the Dissolution Period and the investors' decision in this regard. Further, SEBI *vide* its circular dated July 09, 2024[2], prescribed the format of the information memorandum that the Investment Manager shall be required to file along with a due diligence certificate of a merchant banker to be obtained before the expiry of the liquidation period.
(iii) The Investment Manager cannot charge any management fee to the investors of the scheme during the Dissolution Period.
(iv) The value of the unliquidated investments, to capture the track record of the Investment Manager, shall be (a) bid value, if the investment manager arranges a bid for a minimum of 25% of the value of the unliquidated investments; or (b) INR 1/- in other cases.
(v) Performance of the manager during the dissolution period has to be captured separately and reported to performance benchmarking agencies.

SEBI has also clarified that if the Investment Manager fails to dispose of the unliquidated investments during the Dissolution Period, no extension to the Dissolution Period shall be provided

and the investments must be mandatorily distributed *in specie* to the investors. No further extension or Liquidation Period shall be available to these schemes after the expiry of Dissolution Period.

(b) Mandatory In Specie Distribution

In case the Investment Manager fails to obtain requisite investor consent for either entering the Dissolution Period or *in specie* distribution during the liquidation period, then mandatory *in specie* distribution shall take place without seeking any consent of the investors. SEBI has also provided that the value of unliquidated investments distributed *in specie* shall be recognised at INR 1/- for capturing the track record of performance of the manager and for reporting to performance agencies. Further, if any investor is not willing to take the *in specie* distribution of unliquidated investments, such investments shall be mandatorily written off.

(c) One-time extension for AIF schemes whose liquidation period has expired, to deal with unliquidated investments

Considering there were AIF schemes whose liquidation period had expired prior to the notification of provisions relating to the Dissolution Period, SEBI provided a one-time extension of the liquidation period till April 24, 2025 to all such schemes whose liquidation period had expired or shall expire on or before July 24, 2024.

However, the extension was provided only to such schemes that do not have any pending investor complaint(s) with respect to non-receipt of funds/securities as on April 25, 2024. In case any such complaint existed, the scheme may avail the additional liquidation period facility after resolving the investor complaints, however from the date of resolution of complaint till April 24, 2025. The Investment Manager shall be required to either liquidate its investments or make *in specie* distribution or opt for the Dissolution Period.

(d) In specie distribution during the tenure of the scheme

SEBI *vide* its circular dated July 09, 2024 has clarified that *in specie* distribution of the investments can be undertaken under Regulation 29(8) of the AIF Regulations, i.e., during the tenure of the scheme, only with the consent of 75% of the investors by value of their investment in the scheme.

2. Creation of encumbrance on assets of investee companies of AIFs

In order to promote ease of doing business and facilitate debt-fund raising by investee companies, SEBI *vide* the SEBI (Alternative Investment Funds) (Second Amendment) Regulations, 2024

along with circular dated April 26, 2024[3] has permitted Category I and II AIFs to create encumbrance on their holdings of equity in investee companies.

SEBI has provided that encumbrance may be created on equity of investee companies which is in the business of development, operation or management or projects in any of the infrastructure sub-sectors listed in the Harmonised Master List of Infrastructure issued by the Central Government, only for the purpose of borrowing by such investee company and subject to the following:
(i) Borrowings made by investee companies are not utilized for any purpose other than the development, operation or management of the investee company and the same should be captured in the investment agreement entered into between the concerned AIF and investee company.
(ii) Schemes that have not onboarded any investors prior to April 25, 2024, may create encumbrance on equity of the investee company, subject to explicit disclosure with respect to the creation of such encumbrance and disclosure of associated risks in the PPM of the scheme of AIF.
(iii) Any encumbrance already created by any scheme prior to April 25, 2024, on the securities of investee companies for the purpose of borrowing of such investee companies, may continue if such encumbrance was created after making explicit disclosures in the PPM of the concerned scheme.
(iv) In case any encumbrance has been made without an explicit disclosure in the PPM such encumbrances was permitted to be continued with only if the encumbrances were created on securities of investee company which were permitted under the circular and consent of all investors in the concerned scheme has to be obtained by October 24, 2024. If consent of all investors had not been obtained by October 24, 2024, the encumbrances were required to be removed by January 24, 2025. However, in case encumbrances were created on securities of the investee company that were not permitted under the circular, such encumbrances were to be removed by October 24, 2024.

SEBI also clarified that the duration of encumbrance created on the equity investments shall not be greater than the residual tenure of the scheme and that in case of default by the borrower investee company, the investors of the schemes of AIFs are not subject to any liability over and above the equity of the borrower investee company encumbered by the AIF. SEBI had further clarified that the circular should not be interpreted to mean that AIFs are allowed to extend guarantees for the investee companies.

SEBI also specified that any Category I or II AIF with more than 50% foreign investment or with foreign sponsor/manager or with persons other than resident Indian citizens as external members in its investment committee, which is set up to approve its decisions, shall ensure compliance with conditions laid down under FEMA norms as though it is a person resident outside India. Further, encumbrance is not permitted to be created on foreign investee companies.

3. Relaxation in requirements of intimating changes in terms of PPM of AIFs through merchant bankers

SEBI *vide* circular dated April 29, 2024[4], has provided certain relaxations for AIFs for changes undertaken to the certain identified sections stated in the circular, while intimating changes to the terms of PPM to SEBI through merchant bankers. LVFs have been exempted from the requirement by submitting an undertaking by the CEO of the Investment Manager.

4. Eligibility criteria for the key investment team of AIFs

SEBI, on May 10, 2024, notified Regulation 4(g)(i) of the AIF Regulations whereby the key investment team of an Investment Manager of an AIF shall have at least one key personnel with relevant certification as specified by SEBI as an eligibility criterion for obtaining certification of registration as an AIF.

Following the same, SEBI *vide* circular dated May 13, 2024[5], provided that under the said regulation, at least one key personnel of the key investment team member must have a valid NISM Series XIX-C: Alternative Investment Fund Managers certification. SEBI provided that all applications for AIF registrations and launch of schemes by AIFs filed after May 10, 2024, shall be required to meet the condition immediately, while for existing schemes or schemes of AIFs whose application for launch of scheme pending with SEBI as on May 10, 2024, must comply with the certification requirement on or before May 09, 2025.

5. Migration of Venture Capital Funds ("VCF") to AIF Regulations

SEBI *vide* the SEBI (Alternative Investment Funds) (Third Amendment) Regulations, 2024 and the circular dated August 19, 2024 brought significant regulatory changes with respect to VCFs. To bring greater flexibility, particularly when it comes to managing unliquidated investments after a scheme's tenure has ended, SEBI introduced a new segment of Migrated VCFs which are VCFs registered under the SEBI (Venture Capital Funds) Regulations 1996 ("**VCF Regulations**") and subsequently registered under the AIF Regulations as a sub-category of Category I AIFs ("**Migrated VCF**").

SEBI has also provided conditions and modalities with respect to VCFs while categorizing them based on whether they opt for or can opt for migration. A summary of the same is provided herein:

(a) Conditionalities for VCFs with schemes whose liquidation period has not expired

VCFs with schemes whose liquidation period has not yet expired can opt for migration up until July 19, 2025. In this regard, the tenure of such schemes post-migration will depend on the disclosures made under the VCF Regulations. If a definite tenure was disclosed in the PPM of the scheme, that tenure will remain unchanged upon migration. However, if no definite tenure was disclosed, the residual tenure shall be determined with the approval of at least 75% of investors by the value of their investment in the scheme, prior to application for migration.

(b) Conditionalities for VCFs having at least one scheme which has not been wound up post expiry of its liquidation period

SEBI has provided that such VCFs can apply for migration only if there are no pending investor complaints related to the non-receipt of funds or securities as on the application date. Further, these VCFs have been granted a one-time additional liquidation period of one year, extending up to July 19, 2025. Moreover, in instances where a VCF has a mix of schemes, i.e., some with expired liquidation periods and others that are still within their liquidation timeline, the tenure of the unexpired schemes will be determined based on the provisions outlined for schemes without a definite tenure (as stated above).

(c) Conditionalities for VCFs that do not opt for migration

In case VCFs with schemes whose liquidation period has not expired opt not to migrate, SEBI has mandated enhanced regulatory reporting, which shall be in line with the reporting standards applicable to AIFs under the AIF Regulations. Further, VCFs with at least one scheme whose liquidation period has expired shall be subject to regulatory actions for continuing operations beyond the original liquidation period.

(d) Conditionalities for VCFs that do not have the option to migrate to AIF Regulations

SEBI has clarified that the option to migrate to the AIF Regulations is not available to VCFs whose all schemes have been wound up or no investments have been made by the schemes of the VCF. Such VCFs were expected to surrender their registration by March 31, 2025; failure to do so will result in appropriate action to cancel the certification of registration.

6. Guidelines for borrowings by Category I and II AIFs

SEBI *vide* the SEBI (Alternative Investment Funds) (Fourth Amendment) Regulations, 2024 along with its circular dated August 19, 2024[6], has amended Regulation 16(1)(c) and Regulation 17(1)(c) to allow Category I and II AIFs to borrow funds or engage in leverage.

SEBI has provided that Category I and II AIFs may borrow funds or engage in leverage only to meet temporary funding requirements and day-to-day operational requirements for not more than 30 days and not more than 4 instances in a year. Further, the amount of such borrowing/leverage should not be more than 10% of the investable funds of a scheme.

In addition to the above, the following additional conditions shall be required to be complied with:
(i) If the AIF intends to borrow funds to meet the shortfall in the drawdown amount, the same shall be disclosed in the PPM of the scheme. Such borrowing shall be done only in case of emergency and as a last recourse, when the investment opportunity is imminent to be closed and the drawdown amount from investor has not been received by the AIF before the date of investment, despite the best efforts by manager to obtain the drawdown amount from the delaying investor(s).
(ii) The amount borrowed shall not exceed 20% of the investment proposed to be made in the investee company, or 10% of the investable funds of the scheme of AIF, or the commitment pending to be drawn down from investors other than the investor(s) who have failed to provide the drawdown amount, whichever is lower.
(iii) The cost of such borrowing shall be charged only to investors who failed to provide the drawdown amount for making investments.

Further, in order to ensure pari-passu rights and greater transparency, SEBI has mandated that the flexibility of borrowing to meet shortfall in drawdown amount shall not be used as a means to provide different drawdown timelines to investors and the Investment Manager of the AIF shall disclose the details with respect to amount borrowed, terms of borrowing and repayment to all the investors of the concerned scheme, periodically as per the terms of agreement with the investors of the scheme.

Lastly, there is a requirement to maintain a 30-day cooling period between two periods of borrowing, which shall be calculated from the date of repayment of the previous borrowing.

7. Maximum limit for extension of tenures of Large Value Funds

SEBI *vide* the SEBI (Alternative Investment Funds) (Fourth Amendment) Regulations, 2024 along with its circular dated August 19, 2024[7], amended Regulation 13(5) of the AIF Regulations to

provide that Large Value Funds ("**LVF**") may extend its tenure up to 5 years subject to approval of two-thirds of unit holders of the LVF by value of their investment in the LVF.

Prior to the above notification, the maximum permissible extension period for LVF scheme was not prescribed, and thus considering the same SEBI provided that for existing LVF schemes that had not disclosed a definite period of extension in their tenure in the PPM or whose period of extension in tenure was beyond the permissible 5 years, were required to align the period of extension on or before November 18, 2024 and the same was required to be captured in the quarterly report submission for the quarter ending December 31, 2024. However, SEBI also offered flexibility to such LVF schemes to revise their original tenure, subject to the consent of all investors of the LVF scheme and an undertaking to that effect was to be submitted on or before November 18, 2024, specifying that consent of all investors of the LVF scheme have been obtained for revising the original tenure of the scheme.

8. Modification in valuation framework of AIFs for investment portfolios

SEBI had prescribed conditions in order to ensure that AIFs adopt a standardized and consistent approach for valuation of their portfolio investments. Under the conditions, valuation of securities for which valuation norms have already been prescribed under SEBI (Mutual Funds) Regulations, 1996 ("MF Regulations"), shall be carried out as per the norms prescribed under MF Regulations while for other securities valuation shall be as per guidelines endorsed by any AIF industry association, which in terms of membership represents at least 33% of the number of SEBI registered AIFs.

However, pursuant to suggestions received on the consultation paper floated, SEBI *vide* its circular[8] has now provided that securities which are unlisted and listed securities which are non-traded and thinly traded, the valuation norms/guidelines endorsed by the International Private Equity and Venture Capital Valuation (IPEV) guidelines shall be followed by AIFs. SEBI has also clarified that any change in valuation methodology/approach by AIFs for complying with the circular or any regulatory prescription will not be construed as a 'material change' under the ambit of the AIF Regulations. However, upon carrying out any such change or modification, the valuation carried out on the investment portfolio based on both the old and the new methodology must be duly disclosed to investors in order to ensure transparency.

In addition to the above, SEBI has prescribed eligibility criteria for an independent valuer, who may undertake a valuation exercise, which includes:

(i) a 'Registered Valuer Entity' registered with the Insolvency and Bankruptcy Board of India (IBBI); and
(ii) The deputed/authorised persons of such 'Registered Valuer Entity' who undertakes the valuation exercise must have a membership of Institute of Chartered Accountants of India (ICAI) or Institute of Company Secretaries of India (ICSI) or Institute of Cost Accountants of India (ICMAI) or a CFA Charter from the CFA Institute.

SEBI had also extended the timeline for reporting valuation based on audited data of investee companies of AIF schemes from 6 months to 7 months, i.e., to October 31.

9. Specific due diligence of investors and investments of AIFs

SEBI has identified the need to undertake certain measures to ensure that AIFs are not used to circumvent laws. Therefore, SEBI *vide* the SEBI (Alternative Investment Funds) (Second Amendment) Regulations, 2024 along with its circular dated October 08, 2024[9], has prescribed measures for AIFs, their Investment Manager and key personnel to carry out specific due diligence on investors and investments made by the AIFs.

Various due diligence prescribed by SEBI are listed below:

(a) Investors availing benefits designated for Qualified Institutional Buyers ("QIB")

Under Regulation 2(1)(ss) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("**ICDR Regulations**"), AIFs are designated as QIBs, which allows AIFs to enjoy certain benefits under ICDR Regulations, including acting as anchor investors in Initial Public Offers.

However, to prevent AIFs from facilitating investors to avail benefits as QIBs, who are otherwise ineligible for QIB status on their own, SEBI has mandated specific due diligence for every scheme of AIFs having an investor or investors belonging to the same group [which shall mean 'related parties' and 'relatives' as specified under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015] who contribute 50% or more to the corpus of the scheme prior to availing benefits available to QIBs under ICDR Regulations and other SEBI Regulations.

(b) Investors availing benefits designated for Qualified Buyers ("QB")

Under Section 2(1)(u) of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("**SARFAESI Act**") AIFs have been notified as QBs, and therefore, are eligible to subscribe to Security Receipts ("SR") issued by an Asset Reconstruction Company ("ARC"). To prevent AIFs from facilitating investors who are otherwise ineligible for QB status on their own, every scheme of an AIF having an investor or investors belonging to the same group, who contributes 50% or more to the corpus of the scheme, necessary due diligence shall be undertaken prior to making any investments in SRs issued by ARCs or availing benefits designated for QBs under the SARFAESI Act.

(c) Reserve Bank of India ("RBI") regulated lenders/entities evergreening their stressed loans/assets

In order to address the issue of ever-greening of stressed loans/assets of RBI-regulated lenders/entities through AIFs and to prevent circumvention of norms with respect to income recognition, asset classification, provisioning and restructuring of stressed loans/assets specified by RBI for its regulated lenders, SEBI has specified following conditions.

Necessary due diligence shall be required to be undertaken if:
(i) the Investment Manager or sponsor is an entity regulated by the RBI; or,
(ii) the investor(s) in the scheme are regulated by RBI; and (a) individually or along with investors of the same group contribute 25% or more to the corpus of the scheme; or (b) is an associate of the manager/sponsor of the AIF; or (c) by itself, or through its representative(s)/nominee(s) has majority or veto power in voting over decisions of the investment committee set up by the manager to approve investment decisions of the scheme; or
(iii) to undertake due diligence on a look-through basis on whether an investor is regulated by RBI, if the investor is an AIF or a fund set up outside India or in International Financial Services Centres in India.

In case any such entity is identified then the Investment Manager shall ensure that the scheme does not make any investment that would lead to the RBI regulated lender/entity acquiring or holding an interest/exposure in the investee company indirectly (that is, through investment in a scheme of an AIF), that they are not permitted to acquire or hold directly.

Further, in case the investments specified under point (a), (b) and (c) above do not meet the due diligence criteria specified by the SFA either such an investor or investors of the same group shall be excluded from the investment (subject to necessary disclosure in the PPM for exclusion of investors) or the investment shall not be made.

To ascertain whether investors from countries sharing land border with India are investing in Indian companies through AIFs, specific due diligence is prescribed for every scheme of AIF where 50% or more of the corpus of the scheme is contributed by investors who are or whose beneficial owners are citizens of/are from/are situated in a country which shares land border with India. Upon carrying out the necessary due diligence, such a scheme must report details of its investment, which would result in the scheme holding 10% or more of equity/equity-linked securities issued by an investee company (on a fully diluted basis), to its custodian within 30 days of investment.

Further, for schemes of AIFs falling under the ambit of provisions above, details of their existing investments where the scheme holds 10 percent or more of equity/equity-linked securities issued by an investee company (on a fully-diluted basis), shall also be reported to their custodians on or before April 07, 2025, in the format as may be specified by SFA.

Furthermore, the Standard Setting Forum for AIFs[10] has specified the due diligence criteria that AIFs had to undertake and report confirmation whether the investments made by the schemes satisfy or do not satisfy the due diligence standards on or before April 07, 2025.

10. Pari-passu and pro-rata rights of investors of AIFs

SEBI *vide* the SEBI (Alternative Investment Funds) (Third Amendment) Regulations, 2024 dated November 18, 2024, followed by circular dated December 13, 2024[11] and implementation standards dated January 28, 2025[12] issued by the Standard Setting Forum for AIFs prescribes that AIFs must have pari-passu in all aspects. Further, the it also prescribes that unless otherwise specified, the Schem shall offer pro rata rights in distribution of proceeds of investments of a scheme, except the returns or profits on the investment is shared with the Investment Manager or sponsor of the AIF (by whatever name called, such as carried interest/additional return), in terms of the contribution agreement executed between them.

However, SEBI has allowed the offering of differential rights to certain investors, provided the following conditions are ensured:
(i) Any such right shall not result in any investor bearing liability accrued or accruing to other investors of the AIF/scheme of an AIF;
(ii) Any such right with respect to non-monetary/non-commercial terms shall not provide control to an investor on the decision-making of the AIF/scheme of an AIF, except in cases where the investor/its nominee is part of any committee set up in terms of AIF Regulations;

[10] https://

(iii) Any such right shall not alter the right(s) available to other investors under their respective agreements with the AIF/manager; and,
(iv) Any such right and eligibility to avail the same shall be transparently disclosed in the PPM of the AIF/scheme of the AIF.

Further, SEBI has permitted certain entities to accept returns that are less than or share losses more than their pro-rata rights in investments of a scheme of an AIF (i.e., by way of subscription to units of classes which are junior or subordinate to other classes), which includes:
(i) Manager or sponsors of the AIF;
(ii) Multilateral or Bilateral Development Financial Institutions;
(iii) State Industrial Development Cooperations; and
(iv) Entities established or owned or controlled by the Central Government or a State Government or the Government of a foreign country, including Central Banks and Sovereign Wealth Funds.

Further, it has been prescribed that the amount invested by the AIF/scheme is not utilized by the investee companies directly or indirectly to repay any obligations or liabilities towards the manager or sponsor of the AIF or their associates.

Considering the above, a positive list has been notified by the Standard Setting Forum for AIFs where differential rights can be offered. The list is provided hereinbelow for ease of reference:

S. No.	Terms of the PPM	Differential rights which may be offered by the AIF
1.	Fund Expenses	For waiving off or reducing the expenses charged to select investors or for the manner or basis of charging the expenses. However, it has been clarified that any increase in expenses attributed/attributable to other investors due to such differential right offered to select investors shall be charged to the manager/sponsor of the AIF and not to the other investors of the fund.
2.	Management Fees	For differences in quantum, manner, or basis of charging management fee to select investors.
3.	Hurdle rate of return	For having differential hurdle rates of return for select investors.
4.	Carried Interest	For having differential carried interest calculated for select investors.
5.	Co-investment rights	For offering co-investment opportunities to select investors. However, the common expenses with respect to the co-investment shall be shared proportionately between the AIF and the co-investors.

6.	Reporting and information rights	For providing/sharing additional information and on a higher frequency to select investors, over and above the information required to be disclosed to all investors under AIF Regulations or as disclosed in the PPM. It is clarified that such additional information shall not include – (a) Sharing/ providing any information that would be in breach of any applicable law; (b) Any information that should be provided/available to all investors of the fund. Any cost associated with the sharing of such information to select investors shall be charged only to the respective investors or to the manager/sponsor of the AIF and not to the fund/other investors of the fund.
7.	Representation on committees constituted by the AIF/scheme of the AIF	For select investors to nominate/appoint a member on the committees of the AIF/scheme, including various conditions relating to term, tenure, remuneration, attendance requirements, information to be provided, voting rights, resignation, subject to applicable provisions of the AIF Regulations, if any.
8.	Most Favoured Nation	For select investors to elect superior beneficial terms/rights provided to other investors of the fund.
9.	Confidentiality of investors' details/information	For sharing details/information of other investors to select investors, subject to specific and explicit consent of respective investors, whose details/information are to be shared.
10.	Representation and warranties	For giving representation and warranties to select investors in the nature of providing certain undertakings and confirmations with respect to the fund or manager or applicable law, etc., subject to representation/warranty not resulting in any right being provided to such investor.

The implementation standards issued by the Standard Setting Forum for AIFs also clarify that:
(i) any information provided to select investors which is in the nature of elaborating on terms/disclosures in PPM or contribution agreement/fund documents, in line with AIF Regulations and circulars issued thereunder, or
(ii) right in the nature of providing specific treatment to select investors, for the investors to comply with laws or regulations applicable to them shall not be considered as a differential right.

SEBI had also mandated AIFs to report differential rights by March 31, 2025 and that any rights which are inconsistent with the implementation standards must be discontinued if they affect other investors' rights. Also, in order to bring greater transparency, the PPM must disclose eligibility criteria for these rights, and any investor meeting the criteria must be offered such rights.

However, in case of Large Value Fund for Accredited Investors ("**LVF**") whose PPMs are filed with SEBI post December 13, 2024, they are exempted from the requirement of maintaining pari-passu rights among investors, provided specific disclosures are made in the PPM and an undertaking in the prescribed format is taken from the investors at the time of their onboarding. Existing LVF schemes may avail exemption from maintaining pari-passu rights among investors, subject to each investor in the scheme specifically providing a waiver to this effect.

11. Classification of Corporate Debt Market Development Fund as Category I AIF

AIF Regulations were amended in June' 2023 to provide a separate Chapter III-C for Corporate Debt Market Development Fund ("**CDMDF**"), a Backstop Facility for the purchase of investment-grade corporate debt securities, to instill confidence amongst the participants in the Corporate Debt Market during times of stress and to generally enhance secondary market liquidity by creating a permanent institutional framework for activation in times of market stress.

In this regard, SEBI *vide* circular dated December 13, 2024[13], provided clarity to market participants that CDMDF shall be considered as Category I AIF in terms of Regulation 3(4) of the AIF Regulations.

12. Relaxation in timelines for dematerialization of investments made by AIFs

SEBI had earlier *vide* circular dated January 12, 2024 provided that any investment made by an AIF on or after October 01, 2024 shall be held in dematerialised form only, irrespective of whether the investment is made directly in the investee company or is acquired from another entity. Further, the investments made by an AIF prior to October 01, 2024 shall be required to be held in dematerialized form by January 31, 2025 if it is made in an investee company which has been mandated under applicable law to facilitate dematerialization of its securities; or the AIF, on its own, or along with other SEBI registered intermediaries/entities which are mandated to hold their investments in dematerialized form, exercises control over the investee company.

SEBI has subsequently provided relaxation on the aforementioned timelines *vide* circular dated February 14, 2025[14], has relaxed the timeline for AIFs to hold investments in dematerialized form

and has extended the timeline for holding investments in the dematerialized form to July 01, 2025 in cases where dematerialization was required by October 01, 2024 and October 31, 2025 in cases where dematerialization was mandated by January 31, 2025.

OTHER KEY UPDATES

13. Issuance of partly paid units to persons resident outside India under Foreign Exchange Management (Non-debt Instruments) Rules, 2019

RBI *vide* circular dated May 21, 2024[15], following Foreign Exchange Management (Non-debt Instruments) (Second Amendment) Rules, 2024 dated March 14, 2024, enabling issuance of partly paid units to persons resident outside India by investment vehicles, notified that any issuances of partly paid units by Alternative Investment Funds to persons resident outside India before the said amendment may be regularized through compounding under Foreign Exchange Management Act, 1999.

Further, RBI has provided that before approaching for compounding, AD Category-I banks may ensure that the necessary administrative action, including the reporting of such issuances by AIFs to the Reserve Bank through Foreign Investment Reporting and Management System (FIRMS) Portal and issuing of conditional acknowledgements for such reporting, is completed.

14. Notification of the SEBI Cyber Security and Cyber Resilience Framework, 2024

SEBI *vide* circular dated August 20, 2024 has notified the Cyber Security and Cyber Resilience Framework, 2024 ("**CSCRF**") applicable to SEBI-regulated entities, including AIFs.

SEBI under CSCRF has categorized intermediaries as qualified RE, mid-size RE, small-size RE and self-certification REs depending upon the number of clients, trade volume, asset under management, etc. The framework provides for procedures and systems to be adopted by REs, including the formation of technology committees, the identification of critical systems based on sensitivity and criticality of business operations and reporting requirements.

Further, SEBI has extended the timeline for adoption of CSCRF to June 30, 2025 *vide* circular dated March 28, 2025.

15. Introduction of Draft Digital Personal Data Protection Rules, 2025

The Ministry of Electronics and Information Technology released the draft Digital Personal Data Protection Rules, 2025 ("**DPDP Rules**") for public comments on January 03, 2025. The DPDP Rules are to be issued under the Digital Personal Data Protection Act, 2023 ("**DPDP Act**"), which prima facie casts substantial obligations on data fiduciaries and data processors who collect, store and process third-party customer data. The data privacy governance and landscape are set to imbibe financial service providers, including AIFs and Investment Managers, who collect and process personal data of customers, to provide services.

CONSULTATION PAPERS AND BOARD MEETINGS

16. Review of regulatory framework for Angel Funds in AIF Regulations

SEBI released a consultation paper on November 13, 2024, seeking public comments on amendments to the regulatory framework for Angel Funds under AIF Regulations in order to enhance clarity, provide operational flexibility and strengthen governance, while ensuring investor protection and supporting the startup ecosystem in India.

The key proposals included:

(i) Eligibility Criteria for Angel Investors: SEBI has proposed that in order to ensure that Angel Funds only attract investors with a sufficient risk appetite, only accredited investors, verified through third-party accreditation agencies, should be allowed to invest through Angel Funds.

(ii) Fundraising and Investment Structure: It is proposed to eliminate the minimum corpus requirement for Angel Funds and focus should be on ensuring sufficient capital through a minimum number of accredited investors. Further, it is proposed to reduce the minimum investment per startup to INR 10 lakhs, with a maximum cap of INR 25 crore, and diversification rules may be relaxed provided each investment involves at least three investors (other than contribution from investment manager/sponsor towards continuing interest).

(iii) Investment Flexibility: It is proposed that Angel Funds may be allowed to make follow-on investments in portfolio companies that are no longer considered startups. However, necessary safeguards shall be placed to ensure the investment remains within the original intent of supporting early-stage companies. It is also proposed to reduce the lock-in period for Angel Fund investments to six months in the event of the sale of such an investment to a third party.

(iv) Investor Consent and Allocation: It is proposed that the requirement for investor consent before each investment should be continued, but each investment opportunity must be offered to

all investors of the Angel Fund, with clear methodologies for investment allocation disclosed in the Private Placement Memorandum ("**PPM**").

(v) Minimum Investment Amount: SEBI has also proposed revising the minimum investment amount and removing the commitment period for investors. Further, investment by sponsor/investment manager may make continuing interest of 0.5% of the investment amount or INR 100,000, whichever is higher, in each investment of an Angel Fund.

(vi) Template PPM and Filing Requirements: SEBI has also proposed standardizing the format for PPM with the requirement of audits for funds exceeding INR 100 crore. Further, it is proposed to mandate that the funds conduct a first close within 12 months from the date of SEBI communication of taking the PPM on record and by onboarding a minimum of 5 accredited investors.

(vii) Performance Benchmarking and Listing: In order to increase transparency, SEBI has proposed that the Angel Funds be required to report performance metrics to benchmarking agencies.

(viii) Transition Period for Existing Funds: SEBI has proposed a period of one year for the existing Angel Funds to adapt to the new regulations, particularly regarding the shift to accredited investors.

17. Review of Regulation 17(a) of AIF Regulations

Presently, Category II AIF is required to hold the majority of its investments in unlisted securities. However, Regulation 62A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 now requires that any entity that has issued listed debt securities can issue fresh debt only in listed form.

The said amendment is likely to reduce the investment universe for Category II AIFs as there is a likelihood that debt securities that could have been issued in unlisted form will now have to be listed. To address this, and to give a fillip to issuance of and trading in lesser rated debt securities, SEBI board has approved that investments of Category II AIFs in listed debt securities rated 'A' or below will be treated as akin to investments in unlisted securities for the purpose of their compliance with minimum investment conditions in unlisted securities.

The notification following approval of the SEBI board is awaited.

INFORMAL GUIDANCE AND ORDERS

18. SEBI order concerning Karvy Capital Alternative Investment Trust and KCAP Alternative Investment Fund

SEBI *vide* order dated January 02, 2025, examined a matter where the holding company of the sponsor and the Investment Manager was not a 'fit and proper' person and its impact on the AIF.

In this matter, SEBI examined to ascertain the satisfaction of the 'fit and proper' criteria by Karvy group AIFs registered with SEBI. In this regard, it was observed by SEBI that as per Regulation 4(f) of the AIF Regulations, one of the eligibility conditions for the grant of AIF Registration is that the applicant, Sponsor and Manager shall satisfy 'fit and proper' person criteria as specified in Schedule II of the Intermediaries Regulations. Further, in case of an unlisted applicant or intermediary, 'fit and proper person' criteria shall apply to any person holding twenty percent or more voting rights irrespective of whether they hold a controlling interest or exercise control. In this matter, Karvy Stock Broking Limited (KSBL) held approximately 100% shareholding in Karvy Capital Limited (KCL), the manager and sponsor of Karvy AIFs. KSBL had its stockbroking registration cancelled by SEBI in May 2023 and thereby it failed to satisfy the 'fit and proper person' criteria. As per the Intermediaries Regulations, if a person fails to satisfy 'fit and proper person' criteria, the intermediary shall ensure that such person does not exercise any voting rights and that such person divests their holding within 6 months from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against such intermediary. However, Karvy AIFs failed to ensure the same.

Despite the above, SEBI observed that KSBL was unable to divest its holdings in KCL since it was barred from the securities market for 7 years and due to other legal impediments and ongoing proceedings. Accordingly, in the instant case, the SEBI Adjudicating Officer held that there was no violation of the AIF Regulations.

19. SEBI order concerning Anthill Capital Ventures

SEBI *vide* order dated January 28, 2025, had imposed a penalty on Anthill Capital Ventures, its investment manager and key managerial personnel based on non-compliance observed during the PPM Audit.

During the audit, it was identified that the AIF failed to obtain share certificates in due time. Further, the Fund had granted loans to certain portfolio companies in violation of the AIF Regulations. Lastly, the Fund submitted PPM Audit Reports for FY 2021-22 and 2022-23 with a delay of 7 days and 6 days, respectively.

20. SEBI order concerning KellyGamma Fund

SEBI *vide* order dated February 28, 2025, has imposed a penalty on Kelly Gamma Fund, its investment manager, key managerial personnel and trustee deficiencies reported in the audit of the Fund's Private Placement Memorandum (PPM) and non-compliance noted across several years of operations. SEBI in its order noted that the Fund violated several provisions of the AIF Regulations including investing un-invested funds in non-liquid mutual funds, breaching the 10% investment cap in single investee companies, failing to disclose Net Asset Value to investors quarterly, not submitting quarterly reports for March and June 2023, and providing inaccurate compliance information in its Compliance Test Reports. SEBI also analyzed the Fund's non-enforcement of penalties on a defaulting investor and the delayed issuance of unit certificates, but considering the mitigating factors and in the absence of prejudice and discretion available under the fund documents, they were not considered in violation of AIF Regulations.

In light of these violations, SEBI imposed a total penalty of INR 8 lakh.

21. SEBI Informal Guidance in connection with provisions for Angel funds under the AIF Regulations

SEBI issued an informal guidance on March 13, 2025, providing its interpretations of various provisions relating to Angel Funds.

SEBI, in the said guidance, based on the queries raised by the applicant, observed the following:
(i) The extant AIF Regulations do not allow investment by Angel Funds in entities other than start-ups. This restriction shall also be applicable in the case of investments by Angel Funds by exercising pre-emptive rights in their existing portfolio investee companies, which are no longer start-ups.
(ii) The first investment by an Angel Fund in each investee company/start-up shall not be less than INR 25 Lakhs. However, the requirement of a minimum investment amount of INR 25 Lakh shall not apply to any additional/follow-on investment made by the Angel Fund in its existing portfolio investee company/start-up.
(iii) Corpus of the Angel Fund will include the total amount of funds committed by the investor to the AIF, including fees/costs/expenses payable to the Fund.
(iv) A trust cannot be an angel investor in an Angel Fund unless it is registered as an AIF or VCF.

22. SEBI enquiry order concerning Karvy Capital Alternative Investment Trust and KCAP Alternative Investment Fund

About Us:

At IC RegFin Legal (formerly practicing under the brand IC Universal Legal / ICUL), our core philosophy revolves around helping our clients accomplish their business and strategic objectives. This philosophy is built upon a foundation of extensive legal and regulatory expertise, coupled with a profound understanding of the ever-evolving market and economy. With our deep domain knowledge of financial services, asset management / funds, regulatory ("FMAR") and encompassing legal-technical aspects, as well as our adeptness in handling complex transactions, we offer innovative and practical legal and regulatory solutions to empower clients in achieving their overall business and strategic goals efficiently. At IC RegFin Legal(formerly practicing under the brand IC Universal Legal / ICUL), we take pride in our dedicated team of highly skilled lawyers who form a part of the FAMR Practice Group. They form the backbone of our commitment to consistently deliver top-notch legal services to our esteemed clients. You may read more about us at www.regfinlegal.com and reach out to us at frp@regfinlegal.com.