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SEBI issues further guidelines addressing various aspects to ensure greater compliance by AIFs

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Background

It was 1st August, 2011 which marked the introduction of Alternative Investment Funds (AIF) Regulations when Securities and Exchange Board of India (SEBI) issued a concept paper and draft regulations for AIF for public comments. The thought process after taking due consideration of the various stakeholders was notified on 21st May, 2012 by the enforcement of **SEBI (Alternative Investment Funds) Regulations, 2012** ¹[AIF Regulations].

A rapid growth of private fund industry and to note their importance for the stability of the financial market, SEBI notified the AIF Regulations, 2012 which attempted to extend the periphery of regulation to govern unregulated funds with a view to invest such funds in accordance with a defined investment policy for the benefit of the investors, encouraging formation of new capital and also investor protection to the optimum.

Behind this backdrop, SEBI defined AIF to mean any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which is a privately pooled investment vehicle which collects funds from investors (Indian/Foreign) for investing such funds in accordance with a defined investment policy for benefit of the investors and the manager of such fund, irrespective of their legal domicile. Currently, as on 31st May, 2014² there are 106 AIFs registered with SEBI

Subsequently, to embark the proper adoption of the AIF Regulations, 2012 SEBI vide Circular No. **CIR/IMD/DF/10/2013**³ dated July 29, 2013 issued the operational and reporting norms for AIFs. Subsequently, certain amendments were made in the principal regulations on September 16, 2013⁴. To ensure smooth conformity with such operational guidelines, SEBI further vide Circular No. **CIR/IMD/DF/14/2014**⁵ dated 19th June, 2014 introduced the “Guidelines on disclosures, reporting and clarifications under AIF Regulations”.

An overview of the major highlights of SEBI guidelines on disclosures, reporting and clarifications for AIF is enlisted below:-

¹ http://www.sebi.gov.in/cms/sebi_data/attachdocs/1337601524196.pdf

² http://www.sebi.gov.in/cms/sebi_data/attachdocs/1381741901306.pdf

³ http://www.sebi.gov.in/cms/sebi_data/attachdocs/1375094611151.pdf

⁴ http://www.sebi.gov.in/cms/sebi_data/attachdocs/1379324597638.pdf

⁵ http://www.sebi.gov.in/cms/sebi_data/attachdocs/1403173065618.pdf



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SEBI guidelines for Alternative Investment Funds [AIFs]

I. Submission of Information to SEBI:-

- a) SEBI modified the requirement of submission of report to the custodian appointed by the sponsor or the manager of the Category III AIF. Category III AIFs are now required to report the amount of leverage **as at the end of the day (based on closing prices) by the end of next working day**. The pre-existing operational guidelines advocated for the such reporting on the same day which has now been eased out in view of dependency on various parties to provide information to be submitted.
- b) Any existing AIFs which has not accepted any fresh funds from the investors after the commencement of the said AIF Regulations, 2012 are exempted from registration with the Board. SEBI has therefore mandated such AIFs to disclose information of their activities to SEBI in the following manner:-
 - Such AIFs are required to fill in the relevant details in the Excel Sheet provided in the SEBI website under the name “Information to be filled by the unregistered funds”
 - Such information shall be mailed to SEBI within 30 days from 19th June, 2014. *(i.e. the date of the SEBI circular on Guidelines on disclosures, reporting and clarifications under AIF Regulations)*
- c) Those AIFs where all the moneys have been returned to all the investors and have thereby closed/ wound up are not required to submit any information as aforesaid.
- d) In case of those AIFs which have introduced multiple schemes shall submit relevant information pertaining to such schemes which are in operation on the date of commencement of the AIF Regulations, 2012.

II. Placement Memorandum:-

SEBI has made the following clarifications pertaining to the AIFs Placement Memorandum as below:-

- a) Every AIFs shall in a detailed tabular format disclose the amount of fees and charges that would be applicable to the investors including the distribution waterfall.
- b) Every such placement memorandum shall disclose therein disciplinary history of the following:-



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- AIF, sponsor, manager and their Directors/partners/promoters and associates;
- if the applicant is a trust, disciplinary history of the trustees or trustee company and its directors;
- details of outstanding/pending and past cases (where the person has been found guilty) of litigations;
- details of any criminal or civil prosecution, disputes and non-payment of statutory dues;
- details of any overdues to/defaults against banks or financial institutions;
- details regarding any contingent liabilities which is not provided for;
- details of any proceedings initiated for any economic offences or civil offences if any;
- details of any adverse findings with respect to compliance with securities laws;
- details of any penalties levied.
- details of any disciplinary action taken by the Board or any other regulatory authority.

c) All the existing AIFs shall disclose the following information in its placement memorandum namely:-

- amount of fees and charges applicable to the investors, and
- details of any disciplinary history within 30 days from 19th June, 2014 (*i.e. the date of the SEBI circular on Guidelines on disclosures, reporting and clarifications under AIF Regulations*)

A copy of the such information shall also be filed with SEBI at least 7 days prior to sending the same to the investors

d) Any changes in the final copy of the placement memorandum as against the draft submitted to SEBI shall be clearly stated in the covering letter and also highlighted in the final copy of the placement memorandum.

e) SEBI has mandated that all AIFs shall intimate any change to the placement memorandum to all unit holders (including investors who have provided commitment to the AIF) within 7 days of making such change. In addition such changes shall also be intimated to SEBI.

f) SEBI has provided additional operational guidelines in case of any material change which significantly impacts the investors decision. The material change can be of the following nature, but not restricted to the list below namely:-

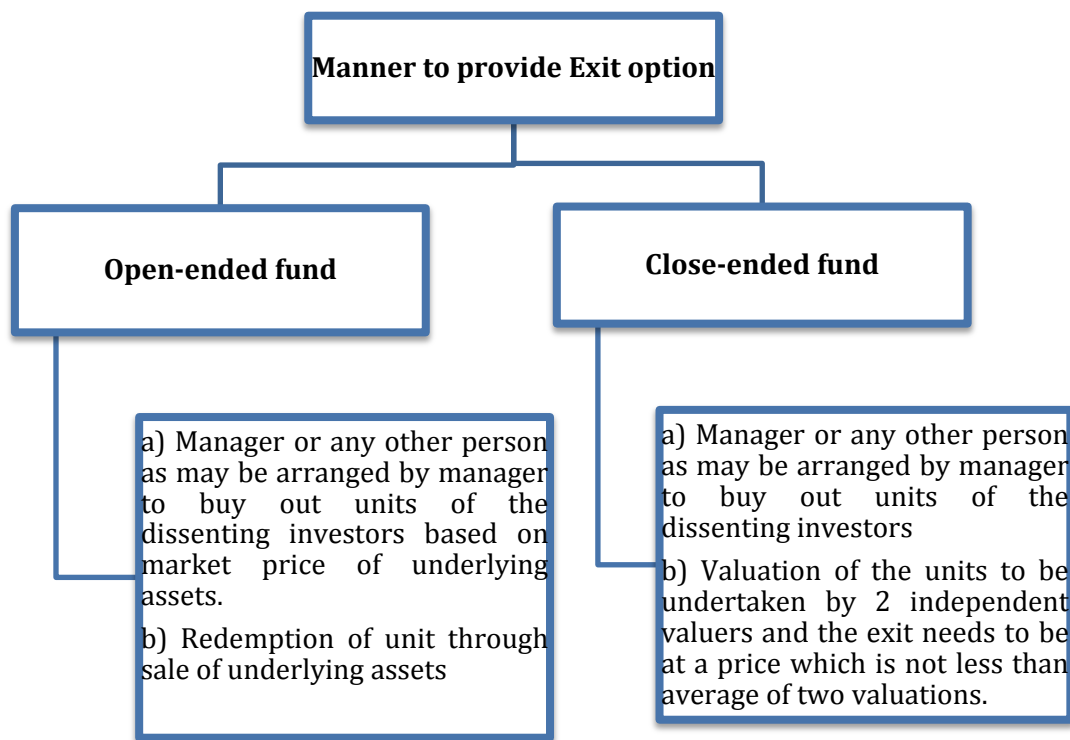
- Change in sponsor/manager (not including an internal restructuring within the group);
- Change in control of sponsor/manager;



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- Any Change in fee structure or hurdle rate which may result in higher fees being charged to the unit holders.

The dissenting unit holders will be required to express the same within 30 days and shall be provided with an exit option. The responsibility to provide the exit option will be on the manager. The expenses for the entire process shall not be charged to the unit holder and will be borne by manager/sponsor/proposed new manager or sponsor. The entire process is to be completed within 3 months from the date of expiry of last date of offer for dissent.



III. Investment Conditions in AIF:-

- Regulation 2(1)(h) of the AIF Regulation defines "corpus" as the total amount of funds committed by investors to the AIF by way of a written contract or any such document as on a particular date.

SEBI now proposes that in case the investment in an open ended scheme falls below Minimum Corpus of Rs. 20 crores (Regulation 10(b) of AIF Regulations, 2012) then such AIF must comply with the following norms :-

- Such AIF shall intimate to SEBI within 2 days of receiving request for redemption from the investor;



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- It shall take necessary action to bring back the scheme size to twenty crores within 3 months from the date of such breach;
- In case of such failure, the AIF shall redeem entire units of all investors;

b) Regulation 10(c) of AIF Regulations, 2012 states that in case the investment is made by an employee of the Manager of AIF, the minimum investment level shall be twenty five lakhs rupees.

In this connection, SEBI has clarified that in case the units of AIF which are issued to such employees without any contribution or investment from them such not attract the minimum investment limit as stated above.

c) In case any investment is made by the manager/sponsor of AIF, SEBI has clarified that such manager/ sponsor shall share the loss in proportion to their investment holding in such funds.

d) An AIF shall accept any investment of not less than one crore rupees from the following joint holder's namely:-

- an investor and his/her spouse;
- an investor and his/her parent;
- an investor and his/her daughter/son

Such joint holders shall not consist of more than 2 persons in any such investment.

e) For the purpose of continuing interest of the manager/ sponsor in an AIF, such interest shall be maintained on a pro- rata basis to the net amount of funds raised from the other investors from the AIF.

f) An AIF shall not invest in units of another AIF unless it is fund of AIFs

g) In case of investment in a real- estate or infrastructure projects by an AIF, such investee company shall not hold less than one project.

h) Prior to making an investment in any associates, an AIF shall mandatorily obtain the approval of the investors.

i) In case of investment in an open ended investment scheme, the first single lump-sum investment amount received from the investor should not be less than the minimum



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investment amount⁶ and such investment amount shall be retained throughout, even after partial redemption of units.

- j) The pooling vehicles created for the purpose of investment in an AIF shall be registered with SEBI for this purpose.
- k) SEBI has mandated the compliance of all KYC norms and all SEBI guidelines relating to Anti- Money Laundering and Outsourcing of Activities to the AIFs and the manager of such AIFs

IV. Compliance Test Report (CTR):-

CTR to be prepared by the Manager of AIF on compliance with AIF Regulations and the circulars

In case the AIF is a trust, the CTR shall be submitted to the trustee and sponsor within 30 days from the end of the financial year

In any other case, the CTR shall be submitted to the sponsor only within 30 days from the end of the financial year

The trustee/sponsor shall intimate any observations/comments on the CTR to the manager within 30 days from the receipt of the CTR. The manager shall make necessary changes in the CTR within 15 days from the date of receipt of observations from the sponsor/trustee on such CTR and thereafter submit its reply to the sponsor/trustee

The Trustee/ sponsor are required to intimate SEBI in case of any violation of AIF Regulations or circulars. The CTR is an exhaustive reporting of compliance of AIF regulations and circulars issued.

⁶ As per Regulation 10 (c) of AIF Regulations, the Alternative Investment Fund shall not accept from an investor, an investment of value less than one crore rupees:

Provided that in case of investors who are employees or directors of the Alternative Investment Fund or employees or directors of the Manager, the minimum value of investment shall be twenty five lakh rupees.



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Clarification Circular

SEBI vide Circular No. **CIR/IMD/DF/16/2014**⁷ dated 18th July, 2014 made certain clarifications as regard the 'Guidelines on disclosures, reporting and clarifications under AIF Regulations, 2012, issued on 19th June, 2012. In that connection the following issues were noted being:-

- a) It has extended the deadline for submission of such placement memorandum in case of existing AIFs to 31st August, 2014.
- b) SEBI made the following clarifications as regards the disclosure to made in connection with the disciplinary history in its placement memorandum:-
 - The applicability of disclosure of disciplinary history shall be restricted for the last 5 years and in cases where the monetary penalty is greater than Rs. 5 lakhs.
 - With respect to disputed tax liabilities forming part of the disclosure of disciplinary history to be made to SEBI, the same shall not apply in respect of liabilities in personal capacity of an individual.
 - The contingent liabilities shall be disclosed in the books of account of the entity.
- c) Any change in the placement memorandum which needs to be intimated to SEBI and also to all the unit holders shall include any modifications in terms or documents of the fund/scheme. Such change shall be intimated to the investors and SEBI once every six months on a consolidated basis.
- d) SEBI has provided clarity as to the constitution of the term material changes in the placement memorandum. It shall be construed to mean any changes in the fundamental attributes of the fund/scheme.
- e) For the purpose of joint investors, both the investors must contribute towards the AIF.
- f) Where an AIF invests in a real estate or infrastructure project, SEBI has clearly stated that the investee company can hold or propose to hold either directly or indirectly not less than one project.

⁷ http://www.sebi.gov.in/cms/sebi_data/attachdocs/1405675574305.pdf



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Conclusion

Certainly the Union Budget 2014-15, stressed on boosting the starved capital market. SEBI has left no stone unturned on ensuring more transparency in the capital market and also protection and promotion of investor interest. Such steps taken by SEBI for stricter operational norms for AIF would ensure greater oversight and accountability to both the regulator and the investors.

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