

Alternate Investment Funds: Key Changes Brought In By SEBI In 2020

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SEBI AIF Regulations 2020: Key Changes in the Investment Policy as Defined by SEBI

The Security Exchange Board of India ("SEBI") is responsible for the primary and secondary security market regulation in India. SEBI acts as a surveillance mechanism for all participants in the security market for intermediaries such as Stock Exchanges, Stock Brokers, Portfolio Managers, etc.

The Alternate Investment Fund or AIF refers to any fund incorporated or established in India, which is a privately pooled investment fund from sophisticated investors, be it Indian or foreign, for the purpose of investment. Such investment is guided by a defined investment policy, regulated by the SEBI (Alternate Fund Investment) Regulations, 2012. This article aims to highlight the key circulars and amendments pertaining to AIF in the year 2020.

We shall be reviewing four sets of circulars released by SEBI in the year 2020. The first circular is on the Disclosure Standards for AIFs, released on February 05, 2020 ("CIRCULAR-1") followed by its clarification on June 12, 2020 ("CIRCULAR-2"). SEBI has also released a circular on Collection of stamp duty on the issue, transfer and sale of AIF units dated June 30, 2020 ("CIRCULAR-3"). Another circular on the processing of applications for registrations of AIFs and the launch of schemes dated October 22, 2020 ("CIRCULAR-4") was released by SEBI.

CIRCULAR-1[1]

The key points of this circular are highlighted below:

Requirement of a template for Private Placement Memorandum (PPM)- In order to streamline the information and disclosure standards, SEBI decided to mandate a template for PPM, which has to provide some level of preliminary information to prospective investors in a format prescribed by SEBI. Such a template is required to have two parts, Part-A should be the section of minimum disclosures, while Part-2 is a supplementary section, allowing any additional information to be provided.

For the purpose of compliance, SEBI makes it mandatory for the AIF to carry out an annual audit of compliance of PPM. The findings of such audit and any corrective step, if any, shall be communicated to the Trustee or Board or Designated Partners of the AIF, Board of the Manager and SEBI.

Aligning Subscription Agreement and PPM- The circular lays down that any subscription agreement shall be in-line with the PPM and should not go beyond the terms stated in the PPM.

Exceptions to AIFs- The circular lays down that the abovementioned guidelines of PPM Template and Audit Requirements would not be applicable to:

- Angel Funds as defined in SEBI (Alternate Investment Funds), Regulations 2012.
- AIFs/Schemes in which each investor commits to a minimum capital contribution of INR 70 crores (USD 10 million or equivalent, in case of capital commitment in non-INR currency) and also provides a waiver to the fund from the requirement of PPM in the SEBI prescribed template and annual audit of the terms of PPM, as provided by the Annexure to CIRCULAR-1.

Performance Benchmarking of AIFs- In order to showcase the performance of different AIFs, in order to let investors make an informed decision, SEBI decided to introduce mandatory benchmarking of the performance of AIFs, and provide a framework for Benchmarking Agencies to provide customized performance report(s).

The circular mentions that any association of AIFs, which represents at least 51% of the number of AIFs in terms of membership shall enter into a Benchmarking Agreement with a Benchmarking Agency. The agreement shall cover the mode and manner of data reporting, information specific to data that needs to be reported, and other terms pertaining to confidentiality of the data received by the Benchmarking Agency.

The circular further goes on to state that for all schemes which have concluded in the past year, AIF shall report necessary information including subject-wise valuation and cash flow data of such schemes to the Benchmarking Agency. Further, if an applicant claims a track-record on the basis of Indian performance of funds incorporated overseas, it shall also provide the data of the investments of the said funds in the Indian companies to the Benchmarking Agencies, when they seek registration as AIF.

In case an AIF mentions past performance in the PPM or any promotional or marketing material, it shall provide a performance vs. benchmark report, generated by the Benchmarking Agency for such a scheme.

Association and Benchmarking Agency shall work in a timely manner, to ensure that the first industry benchmark and AIF level performance versus Benchmark Reports are available latest by July 01, 2020, for the performance upto September 30, 2019. The circular requires the Association to submit a progress report to SEBI till the first industry benchmark has been created. The Performance Benchmarking requirements of AIFs shall not be applicable to Angel Funds registered under the sub-category of Venture Capital Fund under Category I-AIF.

CIRCULAR-2[2]

This circular was issued as a clarification to Circular-1, key points of which are highlighted below:

The First Clarification Provided A Timeline To The Audit Requirement- This states that audit compliance shall be at the end of each financial year, and the findings of the audit and corrective steps, if any, shall be communicated to (i) the Trustee or Board or Designated Partners of the AIF; (ii) Board of the Manager and (iii) SEBI, within 6 months from the end of the financial year.

The requirement of audit compliance shall not apply to AIFs that have not

raised any funds from their investors. However, to substantiate this claim, a Certificate from a Chartered Accountant stating no funds have been raised, shall be submitted within 6 months from the end of the financial year. For the financial year 2019-20, the above requirements shall be fulfilled on or before December 31, 2020.

This circular has also amended the percentage of representation in the association of AIFs. Any association of AIFs, which represents at least 33% of the number of AIFs in terms of membership shall enter into a Benchmarking Agreement with a Benchmarking Agency, which has been changed from the previous 51%.

In light of the Covid-19 pandemic, this circular has extended the submission date of the first industry benchmark and AIF level performance versus Benchmark Reports to October 01, 2020.

Amendment to the Indian Stamp Act, 1899 ("Stamp Act") in light of the Finance Bill, 2019 introduced a single point for collection of stamp duty by authorized/collecting agents, for the issuance and transfer of securities and subsequent disbursement of the duty collected to the respective states. One of the key amendments through the Finance Bill is that the responsibility to collect stamp duty has been fixed on the Stock Exchange, Clearing Corporation and Depository. By virtue of this, the definition of Depository has been amended to include, Registrars to an Issue & Share Transfer Agents ("RTAs") as collecting agents which possess responsibilities of collecting stamp duty in terms of any transactions effected otherwise than through a recognized stock exchange or depository.

CIRCULAR-3[3]

The key features of this circular are as follows:

RTA so appointed by the AIFs shall collect the stamp duty on issue, transfer and sale of units of AIF ("Transactions").

For AIFs that have no appointed RTA, shall appoint one, before July 15, 2020, to enable the collection of stamp duty on Transactions, in compliance with the amended Stamp Act and rules made thereunder.

The AIFs are required to comply with the amended Stamp Act and rules with effect from July 01, 2020. Till such time an RTA is appointed, as an interim measure, AIFs shall keep the applicable stamp duty on Transactions, in a designated bank account. AIFs shall transfer the said amount to RTA upon appointment for onward remittance to States/ Union Territories as per the provisions of the amended Stamp Act and rules made thereunder.

The circular also covers the scenario when Transactions happen through the Stock Exchange and Depositories, where they are already empowered to collect stamp duty as per the amended Stamp Act and rules thereunder.

CIRCULAR-4[4]

While processing applications for registration of AIFs, it was noted by SEBI that the manager of AIF often proposed setting up of an Investment Committee, which may consist of internal and external members, with the mandate to provide investment recommendations or advice to the manager. As per the SEBI (AIF) Regulations, 2012 which were amended on October 19, 2020, (discussed later in the article) manager shall constitute an Investment Committee, to approve the investment decisions of the AIF.

The circular mentions that SEBI seeks clarification from the government and RBI regarding the applicability of clause (4) of Schedule VIII under FEMA (Non-debt Instruments) Rules, 2019, to an investment made by an AIF whose

Investment Committee approves investment decisions and consists of external members who are not 'resident Indian citizens'. Till the time such clarification is issued, SEBI has laid down the procedure for dealing with applications, for the registration of AIFs.

The circular mentions that an application wherein the Investment Committee proposed to be constituted to approve the investment decisions of AIF, includes external members who are 'resident Indian citizens' shall be processed, while the applications where external members are not 'resident Indian citizens' shall only be processed after the clarification SEBI so seeks has been answered.

Amendment to SEBI AIF Regulations, 2012

On October 19, 2020, SEBI notified SEBI (AIF) (Amendment) Regulations, 2020^[5] which made an amendment to Regulation 4(g) and added Regulation 20(6).

The amendment to Regulation 4(g) changed the qualifications of the key investment team of the manager of the AIF. The amended regulations now read as:

"(g) The key investment team of the Manager of Alternative Investment Fund has -

(i) adequate experience, with at least one key personnel having not less than five years of experience in advising or managing pools of capital or in fund or asset or wealth or portfolio management or in the business of buying, selling and dealing of securities or other financial assets; and

(ii) at least one key personnel with professional qualification in finance, accountancy, business management, commerce, economics, capital market or banking from a university or an institution recognized by the Central Government or any State Government or a foreign university, or a CFA charter from the CFA Institute or any other qualification as may be specified by the Board:

Provided that the requirements of experience and professional qualification as specified in regulation 4(g)(i) and 4(g)(ii) may also be fulfilled by the same key personnel."

Further, Regulation 20(6) which was added to the regulations, made the manager of the AIF responsible for all decisions regarding investment in funds. It also provides the manager of AIF with the opportunity to delegate such investment decisions to the Investment Committee, which would be subject to a few conditions as mentioned below:

- The members of the Investment Committee shall be equally responsible as the manager for the investment decisions of the AIF.
- The manager and the members of the Investment Committee would jointly and severally ensure that the investment is in compliance with the SEBI (AIF) Regulations, 2012, terms of placement memorandum, any agreement made with the investor, any other fund document or any other applicable law.
- External members, whose names were not disclosed in the placement memorandum or the agreement made with the investor, shall only be appointed after the consent of at least seventy-five percent of the investors by the value of their investment in the AIF or scheme.

• ^[1]

https://www.sebi.gov.in/legal/circulars/feb-2020/disclosure-standards-for-alt-ernative-investment-funds-aifs-_45919.html

• ^[2]

https://www.sebi.gov.in/legal/circulars/jun-2020/clarifications-with-respect-to-circular-dated-february-05-2020-on-disclosure-standards-for-alternative-investment-funds-aifs-_46847.html

- [3]

https://www.sebi.gov.in/legal/circulars/jun-2020/collection-of-stamp-duty-on-issue-transfer-and-sale-of-units-of-aifs_46983.html

- [4]

https://www.sebi.gov.in/legal/circulars/oct-2020/processing-of-applications-for-registrations-of-aifs-and-launch-of-schemes_47956.html

- [5]

https://www.sebi.gov.in/legal/regulations/oct-2020/securities-and-exchange-board-of-india-alternative-investment-funds-amendment-regulations-2020-_47914.html

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