

Alternative Investment Funds – SEBI's Amendment To Simplify The Process Of Investment

written by Latha Shanmugam | June 11, 2021

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The Securities and Exchange Board of India (SEBI) has issued the second amendment to its Circular, (SEBI Alternative Investment Funds) Regulations, 2021 dated May 05, 2021^[1] to accomplish the long-pending demands of start-ups, venture capital and fund managers. From amending the definitions of start-ups and venture capital undertakings and introducing a code of conduct for fund managers, the objective of the amendment was to bring clarity and accountability regarding investments in the same with specific attention

given to alternative investment funds and their operations.

Start-Ups - SEBI Alternative Investment Funds

Firstly, the SEBI has inserted the definitions of start-ups in Section 2(wa) as defined below:

"...a 'start-up' means a private limited company or a limited liability partnership which fulfils the criteria for a start-up as specified by the Department of Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India, vide notification no. G.S.R. 127(E) dated February 19, 2019 or such other policy of the Central Government issued in this regard from time to time;]"

With the above definition, SEBI ensures that the definition of 'start-up' is in harmony with the definition provided by Department for Promotion of Industry and Internal Trade's (DPIIT) notification dated February 19, 2019^[2] and ensures that there is no uncertainty in the scope of the term as defined by other regulators. The DPIIT Notification specifically states that an entity shall fall into the category of the start-up when it has not been formed by the splitting up or reconstruction of an existing business; is working towards the innovation, development or improvement of products, processes or services and has not exceeded 10 years or an annual turnover of INR 100 crores since its incorporation.

Venture Capital Undertakings

Further, SEBI has modified the definition of venture capital undertakings in Section 2(aa) and removed "restricted activities or sectors" from the earlier definition which opens up a wider scope for investors to invest in companies such as NBFCs and gold loan companies.

According to (SEBI Alternative Investment Fund) Regulations, 2012, a venture capital undertaking (VCU) was defined as a domestic company: -

- which is not listed on a recognised stock exchange in India at the time of making an investment; and
- which is engaged in the business for providing services, production or manufacture of article or things and does not include the following activities or sectors:
 - non-banking financial companies, or NBFCs,
 - gold financing companies,
 - activities not permitted under the industrial policy of the government of India,
 - any other activity which may be specified by SEBI in consultation with the government of India from time to time.

Unlike the above, SEBI has now simplified the definition as below:

"...a 'venture capital undertaking' means a domestic company which is not listed on a recognised stock exchange at the time of making investments..."

Restrictions on Investment

Further SEBI has imposed some limitations on the investment made by the Alternative Investment Funds such as:

- Category I and II of Alternative Investment Funds shall invest only up to twenty-five per cent of the funds in an Investee Company directly or through investment in the units of other Alternative Investment Funds;
- Category III of Alternative Investment Funds shall invest up to ten per cent of the investable funds in an Investee Company directly or through investment in units of other Alternative Investment Funds;
- Alternative Investment Funds which are authorised under the fund documents to invest in units of Alternative Investment Funds shall not offer their units for subscription to other Alternative Investment;
- Alternative Investment Fund shall not invest except with the approval of seventy-five per cent of investors by the value of their investment in the Alternative Investment Fund in (a) associates; or (b) units of Alternative Investment Funds managed or sponsored by its Manager, Sponsor or associates of its Manager or Sponsor.

Code of Conduct

Further, to ensure investor are protected and to bring about transparency and accountability, SEBI has prescribed the Code of Conduct for Alternative Investment Funds, the managers, key management personnel of managers, members of the Investment Committee, trustees, trustee company, directors of the trustees' company, directors, or designated partners of the Alternative Investment Fund. This is clearly specified under the fourth schedule of the Notification dated May 05, 2021, which has streamlined conditions for the above intermediaries accordingly to avoid any mishaps in the investments.

Conclusion

With such amendments, SEBI has intended to strike a proper balance between the accountability of such members and the global regulatory standards for private funds. SEBI's amendment reflects the efforts undertaken by the financial regulators to provide flexibility to AIF managers in operating their funds efficiently and at the same time, has ensured that their fiduciary obligations towards the investors are not compromised. Furthermore, with the above Circular, SEBI has intended to provide comfort to the Alternative Investment Fund managers regarding related compliances.

SEBI's Notification also clarifies the scope and responsibilities of the Alternative Investment Fund manager and members of the investment committee, which is remarkable and should provide requisite operational flexibility to the Alternative Investment Fund and the members of the investment committee. Further, such modifications should aid AIF managers in complying with the applicable laws without diluting protection for investors – which is the ultimate objective of the SEBI.

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- [\[1\]](https://www.sebi.gov.in/legal/regulations/may-2021/securities-and-exchange-board-of-india-alternative-investment-funds-second-amendment-regulations-2021_50089.html)
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