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SEBI DIRECTS INVESTMENT MANAGERS OF AIFS TO APPOINT COMPLIANCE OFFICER AND ISSUES GUIDELINES FOR LARGE VALUE AIFS TARGETING ACCREDITED INVESTORS

1 July 2022 *SEBI in its Circular dated 27 June 2022 has mandated the appointment of Compliance Officer for Investment Managers of all Alternative Investment Funds and has also issued guidelines for Large Value Fund for Accredited Investors relating to filings of fund documents and conditions for extension of tenure of scheme beyond 2 (two) years from the original date of end of their tenure.*

Introduction

In a significant step, which could have an impact on the manner in which compliance, disclosure and reporting functions of Alternative Investment Funds (AIFs) are managed by its investment managers (Manager), Securities and Exchange Board of India (SEBI) in its Circular No. SEBI/HO/AFD/RAC/CIR/2022/088 dated 24 June 2022 (Circular) has mandated the appointment of "Compliance Officer" for investment managers of all AIFs registered with SEBI under the SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations).

The Circular also provides detailed guidelines for Large Value Fund for Accredited Investors (LVFs) relating to filing of scheme documents of LVFs with SEBI and conditions for extension of their tenure beyond 2 (two) years from the original date of end of their tenure.

Part A – Appointment of Compliance Officer for Investment Managers of all AIFs

All AIFs are now required to ensure that the Manager to the AIF designates an employee or director as the Compliance Officer responsible for monitoring compliance with the provision of the Securities and Exchange Board of India Act, 1992, AIF Regulations and circulars issued thereunder. The Circular does not provide any details relating to qualifications or criteria for appointment of Compliance Officer but prohibits appointment of a Chief Executive Officer (CEO) or persons holding any equivalent role or position depending on the legal structure of the Manager as the Compliance Officer.

The Circular does not stipulate any timelines for compliance of the Circular by existing AIFs, but one could assume that the appointment of the Compliance Officer should be made within a reasonable period, especially for existing LVFs, who are required to submit an Undertaking (Undertaking) with SEBI to be signed and stamped by the CEO and the Compliance Officer of Manager to AIF in the format prescribed in the Circular on or before 31 July 2022.

Unlike some of the other market intermediaries regulated by SEBI, including those engaged in asset management business viz., portfolio managers and mutual funds, which under their applicable SEBI regulations are required to appoint a compliance officer, the AIF Regulations did not contain any specific provision for appointment of compliance officer. The AIF Regulations hitherto, merely provided the roles and responsibilities of the Manager, sponsor and

trustee of AIFs without providing any officer specific responsibility or casting any obligation on the person, who shall be liable for ensuring compliance with the applicable laws.

As the AIF industry continues to grow and attract participation from a wider investor base, SEBI has been continuously bringing changes to the regulatory regime to streamline the disclosure standards adopted by AIFs to help investors make an informed choice when investing in AIFs. The introduction of the concept of Compliance Officer appears to be a step in the same direction, acknowledging the systemic importance of AIFs and the need for AIFs to be at par with intermediaries like portfolio managers and mutual funds, in terms of the disclosure and compliance standards adopted by them.

The Circular does not provide for any details regarding the roles and responsibilities of the Compliance Officer, but by virtue of AIFs being 'intermediaries' under SEBI Act 1992, one could draw guidance from the SEBI (Intermediaries) Regulations 2008, which require the Compliance Officer to report to the intermediary or its board of directors, in writing, of any material non-compliance by the intermediary.

Comments

Introduction of the concept of Compliance Officer underscores the importance of AIFs in the current investment ecosystem and its ever-growing attractiveness as an asset class amongst investors. The role of a Compliance Officer would be of critical importance, as direct onus has been placed by SEBI on Compliance Officer for ensuring compliance with the applicable laws and could potentially expose the Compliance Officer to regulatory action in case of any non-compliance by the AIF.

However, one of the other aspects to note here would be that the requirement of naming a Compliance Officer by Manager to AIF already existed since the Compliance Test Report to be filed by Manager to AIF required the naming of a Compliance Officer. The Circular has then essentially codified this previously ad-hoc requirement and made the position to be a mandatory one, distinct from the CEO.

It has long been felt by the industry that the cost of operating AIFs has been ever increasing and the compliance cost has gone up in some form making it more and more unviable for startup Managers or those managing smaller pools of assets to run the AIF business competitively. Further, increasing compliance burden and costs, combined with other tax uncertainties may further prove to be a deterrent for global fund managers from setting onshore structures in India. It would have been preferred if SEBI defined a threshold Assets Under Management beyond which having a Compliance Officer would be mandatory. This could have certainly provided some relief to smaller and startup Managers.

Part B - Guidelines for Large Value Fund for Accredited Investors

Undertaking by the CEO and the Compliance Officer prior to launch of the scheme of LVF

SEBI in August 2021 introduced the concept of LVFs granting certain relaxations for AIFs with Accredited Investors¹. The LVFs are exempted from the requirement of filing of placement memorandum with SEBI at least 30 (thirty) days prior to launch of a scheme and incorporation of SEBI's comments in placement memorandum prior to launch of scheme.

The Circular requires the CEO (or equivalent position, in case of absence of a CEO position) and the Compliance Officer of the Manager to AIF to submit a signed and stamped Undertaking at the time of filing placement memorandum for LVF schemes with SEBI in the format prescribed

¹ means any person who is granted a certificate of accreditation by an Accreditation Agency, subject to meeting the financial parameters prescribed. In addition to the investors who are eligible for accreditation by meeting the prescribed thresholds, SEBI also provides a list of persons who shall be deemed to be Accredited Investors, without requiring such investors to go through the accreditation process.

at Annexure A of the Circular. In case the LVF schemes are already filed with SEBI, such Undertaking is required to be submitted with SEBI on or before 31 July 2022.

The Undertaking as per Annexure A requires the CEO and the Compliance Officer to *inter alia* state that they have independently exercised due-diligence regarding information given in the placement memorandum, including the veracity and adequacy of disclosure made therein; placement memorandum contains all the material disclosures in respect of the fund raising, investment by the scheme and management thereof, based on latest available information; they are satisfied that the proposed activities of the scheme are bonafide, fall within the objectives of the fund as specified in the constituent documents of the AIF and are to meet the stated investment objective; disclosures made in the placement memorandum are true fair and necessary to enable the investors to make an informed decision with respect to the investment in the proposed scheme and such disclosures are in accordance with the AIF Regulations and other applicable requirements. The Undertaking also requires the CEO and the Compliance Officer to submit details of disclosures in the placement memorandum with respect to compliance with AIF Regulations applicable to the proposed LVF scheme and information with respect to disclosures in the placement memorandum. The format of such disclosures is provided in Annexure I and Annexure II of the Undertaking.

Extension of tenure beyond 2 (two) years

AIF Regulations permit close ended AIFs to extend their stipulated tenure by up to 2 (two) years, subject to approval of 2/3rd (two-thirds) of the unit holders by value of their investment in the AIF. LVFs are however, permitted to extend its tenure beyond the 2 (two) year period, subject to terms of the contribution agreement, other fund documents and such conditions as may be specified by SEBI from time to time.

In relation to extension of tenure of LVFs beyond the 2 (two) year period, the Circular provides the following conditions:

- Placement memorandum, contribution agreement or other fund documents of LVF should lay down terms and conditions for extension of the tenure beyond 2 (two) years in order to enable the investors to take an informed decision;
- LVF is required to obtain approval from its trustee / board of directors / designated partners (depending upon the legal structure of the LVF) for extending the tenure beyond 2 (two) years, at least 1 (one) month before expiration of the fund tenure or extended tenure; and
- If the conditions laid out for such extension in fund documents are not satisfied, LVF is required to be liquidated and wound up in accordance with the AIF Regulations.

Comments

The Circular casts an additional obligation on the LVFs to disclose the circumstances upfront, which may warrant extension of its tenure beyond the 2 (two) year period from the expiry of the stipulated tenure. As per SEBI, such disclosure would enable the investor to make an informed investment decision. Such a condition may sound well-meaning and innocuous, but it could potentially take away the flexibility of the LVF to extend its tenure beyond the 2 (two) year period, should an unforeseen situation arise. The investors of LVFs being accredited investors having the sophistication to understand the risks involved should have the discretion to take a decision regarding the extension of tenure of the LVF, after evaluating the then prevailing circumstances.

Further, with the number of instances where AIFs are unable to liquidate their investments beyond the 2 (two) year extended period, in many instances for reasons beyond their control

(e.g., pending litigation, ongoing bankruptcy proceedings, etc.), these AIFs continue to remain in a limbo. Thus, it would be beneficial for AIFs, if SEBI considers allowing similar form of extension periods for all other AIFs in such situations, subject indeed to the consent of investors.

Lastly, the LVF category was created to offer a greater contractual flexibility between a sophisticated investor and a Manager to negotiate their terms of contribution. The pervasive nature of undertakings seems to further dampen this flexibility and may prove to be counter intuitive to creation of this sub-category of AIF. The regulatory philosophy behind introduction of the AIF regime having different categories of funds was to channelize the funds in the desired space in a regulated manner without posing systemic risk. To this end, the AIF Regulations were to provide minimum ground rules for disclosures and governance practices for different category of AIFs to minimize conflict without regulating the business risks. Hence, it would be a fair industry expectation, to let the 'big boys' play by their own rules so long as they are not creating a systemic risk and not burdening SEBI with investor grievance redressals.

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