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SEBI's 2023 Amendments to AIF Regulations: Advancing Transparency, Liquidity, and Investor Protection

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Abstract

This article examines the SEBI (Alternative Investment Funds) (Second Amendment) Regulations, 2023, focusing on key reforms to enhance transparency, investor protection, and regulatory compliance. It also highlights the introduction of the Corporate Debt Market Development Fund (CDMDF), a major step towards boosting liquidity in the corporate bond market. The piece offers a brief yet comprehensive insight into the evolving AIF regulatory landscape.

Keywords: *SEBI Amendments 2023, Alternative Investment Funds (AIF), Dematerialisation of Units, Liquidation Scheme, Investor Consent, Fund Valuation, Compliance Officer, Corporate Debt Market Development Fund (CDMDF), SEBI Regulations, AIF Reforms*

(1.1)- Introduction:

The **Securities and Exchange Board of India (SEBI)** is a statutory regulatory authority functioning under the Union Finance Ministry. It acquired the statutory powers on 30th January 1992 in accordance with the SEBI Act 1992. It plays a crucial role in the Indian financial system by regulating the securities market, ensuring transparency, and protecting investors' interests. It also regulates the functioning of stockbrokers, sub-brokers, portfolio managers, and other intermediaries in the securities market[1].

June 15, 2023, SEBI introduced the **SEBI (Alternative Investment Funds) (Second Amendment) Regulations, 2023**, which brought important changes to the existing **SEBI (AIF) Regulations, 2012**. These amendments were aimed at improving regulatory compliance and enhancing the protection of investor interests in Alternative Investment Funds (AIFs). Key changes include the **introduction of a new category of AIFs**, updates to the **winding-up procedures**, revised **valuation guidelines**, mandatory **appointment of a compliance officer**, and the requirement for **units to be issued in dematerialized (demat) form**, among others.[2].

(1.2)- Key Amendments from the Amendment Regulations:

(1.2.1)- Issuance of Units of AIFs in Dematerialized Form

Post-Amendment Provision:

A new clause has been incorporated into Regulation 10(a) of the SEBI (Alternative Investment Funds) Regulations, 2012[3]. As per the newly added clause 10(aa), all AIFs intending to make investments are now mandated to issue their units in a dematerialized (electronic) form, in accordance with the guidelines and conditions prescribed by SEBI from time to time[4].

Implication of the Amendment:

This change requires Alternative Investment Funds to issue units in electronic format, thereby eliminating the issuance of physical certificates.

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[1] Securities and Exchange Board of India, About SEBI, https://www.sebi.gov.in/about-sebi.html (last visited Apr. 24, 2025).

[2] Commencement Notification for Certain Provisions of the SEBI (AIF) (Second Amendment) Regulations, 2023, SEBI, https://www.sebi.gov.in/legal/gazette-notification/may-2024/commencement-notification-for-certain-provisions-of-the-securities-and-exchange-board-of-india-alternative-investment-funds-second-amendment-regulations-2023_83321.html (last visited Apr. 24, 2025).

[3] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Reg. 10(a).

[4] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Reg. 10(aa).

Objective Behind the Amendment:

The primary aim of this reform is to ensure greater transparency and streamlined operations. It also seeks to minimize operational inefficiencies and potential frauds such as the circulation of counterfeit certificates, delays in issuance, or loss of documents. Additionally, it significantly reduces paperwork, contributing to improved administrative processes.

(1.2.2)- Change in the Winding Up Process of the Scheme of AIF

Post-Amendment Provision:

Under the amended regulations, the winding-up process of an AIF scheme will now be conducted according to the procedure outlined in Regulation 29 of the AIF Regulations[5]. In cases where the unit holders' consent is not obtained, the AIF is required to completely liquidate (wind up its affairs by determining liabilities and distributing assets) within one year after the fund's original or extended tenure expires. Notably, these revised provisions will not apply to existing AIF schemes that have already surpassed one year from the expiration of their tenure or extended tenure.

Pre-Amendment Requirement:

Previously, there was a stipulation requiring approval from 75% of unit holders for the distribution of liquidation proceeds. This requirement has now been removed through the amendments made to Regulation 29.

Objective Behind the Amendment:

The key objective of this amendment is to enhance the efficiency and transparency of the winding-up process for Alternative Investment Funds. It aims to protect investor interests by ensuring that funds are closed in a timely manner without unnecessary delays. The amendment also seeks to streamline the operations of funds, reduce administrative burdens, and foster a more structured and investor-friendly regulatory environment within the AIF sector.

(1.2.3)-Introduction of ‘Liquidation Scheme

Post-Amendment Provision:

A new regulation, Regulation 29A, titled 'Liquidation Scheme,' has been introduced between

[5] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Reg. 29.

Regulation 29 and Regulation 30. This regulation allows existing AIFs to establish a liquidation scheme with the consent of 75% of investors based on the value of their investments in the original scheme[6]. In addition, SEBI issued a circular on June 21, 2023, outlining the procedures for launching a liquidation scheme and the in-specie distribution of investments by AIFs.

Placement Memorandum Requirement:

Before launching the liquidation scheme, a placement memorandum must be filed with SEBI through a merchant banker, along with the payment of the prescribed fees. The tenure of the liquidation scheme will be determined at the time of filing the memorandum and cannot be extended.

Exemptions for Liquidation Scheme:

The amended regulations also specify certain provisions of the AIF Regulations that will not apply to a liquidation scheme. These include requirements such as minimum corpus and the minimum number of investors required for a scheme.

Objective Behind the Amendment:

The introduction of the Liquidation Scheme has made the winding-up process for AIFs more efficient, particularly in scenarios where market liquidity is limited. This amendment provides fund managers with better tools for decision-making and enhances regulatory oversight of the fund's lifecycle and closure timelines.

(1.2.4)- Investor’s consent required for buying/selling certain investments:

Pre-Amendment Provision:

Earlier, Regulation 15 of the SEBI (Alternative Investment Fund) Regulations, 2012 [7]outlined the general investment conditions, but new, stricter conditions have now been added to Regulation 15, sub-regulation (1), following clause (e)[8].

Post-Amendment Provision:

The amended clause stipulates that for any purchase or sale of investments, approval from 75% of investors, based on the value of their investment in the AIF scheme, is required in the following

[6] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Reg.29A.

[7] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Reg. 15.

[8] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Reg. 15(1)(ea).

cases:

(a) Transactions with associates;

(b) Transactions with schemes of Alternative Investment Funds managed or sponsored by the Manager, Sponsor, or their associates; or

(c) Transactions involving an investor who has committed to investing at least 50% of the AIF scheme's corpus.

Exclusion from Voting Process:

In the process of obtaining investor approval, the investor who is committing to invest at least 50% of the AIF scheme's corpus and is buying or selling investments will be excluded from the voting process.

Objective Behind the Amendment:

The primary goal of this amendment to Regulation 15(1) of the SEBI (Alternative Investment Funds) Regulations, 2012 is to strengthen investor protection, increase transparency, and reduce potential conflicts of interest in transactions involving AIFs.

(1.2.5)- Change in valuation procedure and of the methodology of valuing assets:

Post-Amendment Provision:

Regulation 23 addresses the valuation of investments within the AIF.

- In Regulation 23, sub-regulation (1), the phrase "carry out valuation of its investments in the manner specified by the Board from time to time and" has been added after the words "The Alternative Investment Fund shall[9]."
- According to the amendment, the Manager is responsible for ensuring the appointment of an independent valuer by the AIF. The independent valuer must meet the criteria established by the Board as per its guidelines
- The Manager holds responsibility for ensuring a true and fair valuation of the scheme's investments within the AIF.
- Additionally, if the established valuation policies and procedures do not lead to a fair and appropriate valuation, the Manager is required to deviate from these procedures, valuing the assets or securities at fair value. The rationale for such deviation must be documented.

[9] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Reg.23 (1).

Objective Behind the Amendment:

The key objective of this amendment is to improve the accuracy, fairness, and accountability of the valuation process for investments within Alternative Investment Funds.

(1.2.6)- Change in eligibility criteria for key investment team:

I. Pre-Amendment Provision:

Regulation 4 of the SEBI (Alternative Investment Funds) Regulations, 2012 outlines the eligibility requirements for obtaining a registration certificate[10].

One of the requirements stated in this regulation was that the "key investment team" of the AIF manager must have sufficient experience, with at least one key personnel having a minimum of 5 years of experience in areas such as advising or managing capital pools, fund or wealth management, asset or portfolio management, or in the business of buying, selling, and dealing in securities or other financial assets.

II. Post-Amendment Provision:

- The prior provisions have been replaced by sub-regulation III of Regulation 3 of the SEBI (AIF) (Amendments) Regulations, 2023.
- According to the amended norms, at least one key personnel must hold relevant certification as specified by SEBI from time to time[11].
- Additionally, as per clause (g) of Regulation 4 of the SEBI (AIF) Regulations, 2012, the requirement of "experience and professional qualification" has been omitted. A new proviso under this regulation mandates that a fresh certification must be obtained before the expiration of the existing certification to ensure continuity in compliance[12].
- The prior requirement of at least 5 years of experience for a member of the "key investment team" has been removed.

Objective Behind the Amendment:

The recent amendment to the SEBI (AIF) Regulations replaces the previous 5-year experience requirement with a mandate for relevant certification, as prescribed by SEBI. This change aims to establish a more standardized and objective eligibility criterion, improving the professional competence of fund managers. It encourages continuous professional development, aligns with international regulatory standards, and bolsters investor confidence by ensuring that key personnel possess up-to-date and verifiable expertise. Additionally, the amendment expands the eligible talent

[10] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Reg. 4.
[11] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Reg. 3.
[12] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Reg. 4(g).

pool while maintaining regulatory oversight and accountability.

(1.2.7)- Mandatory appointment of a compliance officer:

Pre-Amendment Provision:

Regulation 20 of the SEBI (Alternative Investment Funds) Regulations, 2012 outlines the general obligations, responsibilities, and transparency requirements for AIFs[13].

Post-Amendment Provision:

Under the amended regulations, every AIF is required to appoint a compliance officer. The compliance officer is responsible for ensuring adherence to the provisions of the Act, rules, regulations, notifications, circulars, guidelines, instructions, and any other directives issued by SEBI[14]. The compliance officer must meet the eligibility criteria specified by SEBI for their appointment[15].

Duties of the Compliance Officer:

The compliance officer is tasked with the responsibility of reporting any observed non-compliance directly to the board. The non-compliance must be reported within seven working days of its discovery[16].

Objective Behind the Amendment:

The amendment mandating the appointment of a compliance officer for all AIFs aims to improve internal oversight and ensure strict compliance with SEBI's regulatory framework. The compliance officer, who must meet SEBI's eligibility criteria, is responsible for monitoring compliance with all applicable laws and regulations. A key feature of this amendment is the requirement for the compliance officer to independently report any non-compliance to SEBI within seven working days. This change is designed to enhance transparency, facilitate timely regulatory action, and provide better protection for investors by strengthening the internal compliance mechanisms of AIFs.

(1.2.8)- Introduction of 'Corporate Debt Market Development Fund':

With the recent amendment, SEBI has introduced Chapter III-C, titled "Corporate Debt Market

[13] Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, Reg. 20.
[14] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Reg. 17.
[15] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Reg. 18.
[16] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Reg. 19.

Development Fund[17]," within the SEBI (Alternative Investment Funds) Regulations, 2012. The Corporate Debt Market Development Fund (CDMDF) is designed to facilitate the purchase of investment-grade corporate debt securities during periods of market stress or dislocation. The primary objective of this fund is to instil confidence in the corporate bond market and enhance liquidity in the secondary market.

Key Features of Corporate Debt Market Development Fund (CDMDF) :

➢ **Meaning and Purpose**

The CDMDF serves as a financial safety net intended to purchase investment-grade corporate debt instruments during instances of market stress or disruption. Its primary aim is to instil investor confidence and ensure the smooth functioning of the corporate bond market by enhancing liquidity in the secondary market.

➢ **Legal Formation and Registration**

- **Legal Constitution and Structure**

The Corporate Debt Market Development Fund is to be formed as a Trust, and its legal foundation must be established through a trust deed. This deed needs to be duly registered under the Indian Registration Act, 1908, ensuring that the formation of the trust is legally recognized and enforceable[18].

- **Regulatory Compliance as an Alternative Investment Fund (AIF)**

Once constituted, the Fund is required to seek registration as an Alternative Investment Fund (AIF). This aligns it with the regulatory framework provided under Chapter II of SEBI's AIF Regulations, ensuring that it operates within the defined guidelines for private pooled investment vehicles[19].

- **Disclosure Through Placement Memorandum**

A placement memorandum, which serves as a key document outlining the fund's investment strategy, objectives, structure, and risk factors, must be submitted to SEBI. This allows the regulator to examine the fund's proposal for transparency and compliance[20].

- **SEBI's Oversight and Feedback**

SEBI reserves the right to review and provide comments on the placement memorandum. The Manager of the Fund is obligated to incorporate any such comments before the fund is launched,

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[17] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Ch. III-C, Reg. 19N.

[18] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg. 19O(1).

[19] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Ch. III-C, Reg.19O(2).

[20] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19O(3).

ensuring that the fund's operations begin with regulatory clarity and alignment[21].

- **Tenure and Structure of the Fund**

The CDMDF is to be established as a closed-ended fund with a fixed term of 15 years starting from its first close. The provision for extension exists, but only with SEBI’s prior approval, which adds a layer of regulatory control over the fund’s longevity and continuity[22].

- **Winding Up Procedure**

The fund cannot be wound up at the discretion of the Manager or trustees alone. It requires explicit approval from SEBI, signifying that the regulator maintains final authority over the fund's closure, protecting investor interests and market stability[23].

➢ **Investment in the Corporate Debt Market Development Fund.**

- **Nature and Duration of the Fund**

This fund shall operate as a close-ended scheme, initially set for a term of fifteen years from its first closing. An extension of this term can be allowed only with prior SEBI approval. Similarly, the winding-up of the fund shall also require regulatory consent.

- **Mode of Investment through Units**

Investments in the CDMDF will be channelled through units offered to Asset Management Companies (AMCs) and specified mutual fund schemes that focus on debt instruments. These investments must comply with the requirements under the SEBI (Mutual Funds) Regulations, 1996[24].

- **Minimum Investment by Sponsor or Manager**

To demonstrate ongoing commitment, the fund’s Manager or Sponsor is required to invest a minimum of ₹5 crore in the CDMDF. This obligation cannot be fulfilled by foregoing management fees and must be in the form of direct investment[25].

- **Criteria for Acquisition of Securities during Market Disruption**

  - When the market faces significant dislocation, the CDMDF is permitted to purchase corporate debt securities from eligible mutual fund debt schemes, provided that:

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[21] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19O(4).
[22] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19O(5).
[23] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19O(6).
[24] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19P(1).
[25] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19P(2).

  - The securities are listed and carry a minimum investment-grade rating;
  - Their remaining maturity does not exceed five years at the time of acquisition;
  - There is no significant risk of default, nor any adverse credit reports[26].

- **Investment Strategy during Stable Market Conditions**

In periods where the market is stable, the fund shall focus on low-risk, high-liquidity debt instruments. It is expressly prohibited from investing in securities of foreign-incorporated companies, and its investment in any single company shall not surpass 5% of the total capital of the fund at the time of investment[27].

➢ **Reporting and Transparency Obligations**

To maintain transparency, the CDMDF must disclose its portfolio to its unitholders once every fortnight. Moreover, the Net Asset Value (NAV) of the fund shall be published on a daily basis for the benefit of investors[28].

➢ **Governance and Regulatory Oversight**

- A trustee company must be appointed to oversee the operations of the CDMDF.
- The composition of the trustee company's board and the fund manager's board must receive SEBI's prior approval.
- The trustee company shall be restricted from undertaking any other business activity without written consent from SEBI.
- At least two-thirds of the trustee company's board must consist of independent directors with no affiliations to the Sponsor or Manager.
- The appointment of directors to the trustee company at any stage requires prior clearance from SEBI.
- An audit committee shall be established to ensure adherence to the placement memorandum and applicable laws[29].

➢ **Role of the Governance Committee**

- The Manager shall constitute a Governance Committee for the fund.
- This Committee shall collaborate with the boards of the Manager and the trustee company in framing fund policies.

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[26] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19Q(1).
[27] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19P(2)(3)(4).
[28] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19R.
[29] Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2023, Chapter III-C, Reg.19S.

- It shall supervise matters concerning potential conflicts of interest and ensure sound asset-liability management, especially during periods of financial turbulence[30].

➢ **Expected Benefits of the CDMDF**

The implementation of the CDMDF is expected to significantly strengthen trust in the corporate bond ecosystem. By providing a structured mechanism to support investment-grade bonds during adverse market conditions, it is likely to stimulate higher investor engagement and improve liquidity. Additionally, its registration as a SEBI-regulated trust enhances governance and accountability in its operations.

Objective : The Corporate Debt Market Development Fund (CDMDF) aims to stabilize and enhance liquidity in the corporate bond market by purchasing investment-grade corporate debt during times of market stress. It is structured as a close-ended trust with a 15-year term, designed to foster investor confidence and improve market functioning. The fund operates through unit-based investments, with defined eligibility criteria for purchases, ensuring compliance with regulatory and government guidelines.

(1.3)- Conclusion:

In conclusion, the recent amendments to SEBI's Alternative Investment Fund (AIF) Regulations mark a pivotal shift towards strengthening the regulatory framework for AIFs in India. These changes, which include mandatory compliance officer appointments, streamlined winding-up processes, enhanced investor protection, and the introduction of the Corporate Debt Market Development Fund, are designed to improve operational transparency, market liquidity, and investor confidence. By addressing key issues such as valuation procedures, investor consent, and fund management standards, SEBI aims to create a more robust, efficient, and investor-friendly environment. These amendments reflect SEBI's ongoing commitment to the growth and stability of the Indian financial markets, while ensuring better governance and regulatory compliance in the AIF sector.

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[30] *Id.*

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