SEBI'S PROPOSAL FOR PROVIDING EXITS FROM AIFS

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Introduction

On February 3, 2023, the Securities and Exchange Board of India ("**SEBI**") issued a consultation paper ("**Consultation Paper**") which sought the views of the general public on proposals floated by SEBI for providing options to Alternative Investment Funds ("**AIFs**") and their investors to carry forward unliquidated investments of a scheme upon expiry of its tenure under the SEBI (Alternative Investment Funds) Regulations, 2012 ("**SEBI AIF Regulations**"), while ensuring proper recognition of asset value and fund performance.

The Consultation Paper has listed out the options presently available to an AIF and the investment manager of the AIF ("**Investment Manager**") upon expiry of the tenure of a scheme of the AIF. Under the existing SEBI AIF Regulations, AIFs (other than Large Value Funds for Accredited Investors ("**LVF**")) may extend the tenure of a scheme only up to two years, subject to receiving the approval of two-thirds of the investors by value of their investment in the AIF.[1] LVFs are permitted to extend their tenure beyond two years, subject to the terms of their fund documents and such conditions as may be specified by SEBI from time to time. At the end of their term (including any extension of the term) AIFs may distribute the assets of the AIF in-specie, after obtaining the approval of at least 75% of the investors by value of their investment in the AIF.[2] In case in-specie distribution of residual assets does not take place, AIFs are required to fully liquidate the scheme within one year following expiration of the tenure of the AIF.

The Consultation Paper states that SEBI has, in the recent past, received requests from a few AIFs seeking permission for extension of the tenure of their schemes citing reasons such as lack of liquidity, legal / regulatory impediments, etc. In this context, sample data collected by SEBI for expiry of the tenure of schemes of AIFs suggests that the two-year extension period for 24 schemes of AIFs with a valuation of Rs. 3,037 crores will expire in FY 2023-24. Further, the tenure of another 43 schemes with a valuation of Rs. 13,450 crores will expire in FY 2024-25. In light of this, SEBI's Consultation Paper has put forth a proposal to provide an additional option to AIFs and their investors to carry forward unliquidated investments of a scheme beyond the currently permitted two-year extension of tenure.

SEBI is of the view that ensuring proper recognition and disclosure of true asset quality, liquidity, and fund performance by AIFs/ Investment Managers is a regulatory objective. A full closure of the scheme, recognition of the true asset value, and re-opening of a fresh fund at that value would satisfy both objectives of providing additional flexibility to investors/ funds, while ensuring disclosure and tracking of true asset value and fund performance.

SEBI's Proposal

Transfer of unliquidated investments to a new scheme

SEBI's Alternative Investment Policy Advisory Committee (AIPAC) has recommended that at the end of a scheme's tenure (which would include the permitted two-year extension), instead of liquidating all investments, the AIF may transfer the unliquidated investments to a new scheme, provided not less than 75% of the AIF's investors by value consent to the same. Investors who do not consent to such transfer of unliquidated investments to a new scheme ("**Dissenting Investors**") have to be given an exit. In order to give an exit for the Dissenting Investors, the AIF or its Investment Manager has to arrange bids for a minimum of 25% of the unliquidated investments. If the minimum 25% bid is obtained from related parties of the AIF/ Investment Manager/ sponsor or from other existing investors, the same should be transparently disclosed to all investors. The Consultation Paper says, "*such bids can only be used to provide pro-rata exit to*

[1] As per Regulation 13(5) of the AIF Regulations.
[2] As per Regulation 29(8) of AIF Regulations.

other remaining investors". We assume this means that the bids obtained from related parties of the AIF/ Investment Manager/ sponsor or from other existing investors can only be used to provide pro-rata exit to Dissenting Investors. However, wouldn't even bids from persons other than related parties of the AIF/ Investment Manager/ sponsor or from other existing investors be used only to provide an exit to Dissenting Investors?

What if fresh bids for a minimum of 25% of unliquidated investments cannot be obtained?

The obligation to arrange fresh bids for a minimum of 25% of unliquidated investments does not appear to be mandatory since the Consultation Paper states that where such bids cannot be arranged, the closing valuation of the scheme will be based on the liquidation value as determined under IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, or other applicable IBC norms ("**IBBI Liquidation Value**"). However, if bids are received for a minimum of 25% of unliquidated investments, even if such bids are for a value lower than the IBBI Liquidation Value, the unliquidated investments can be transferred to the new scheme at the bid value and the IBBI Liquidation Value is irrelevant.

Further, even if bids for a minimum of 25% of unliquidated investments are not obtained, an exit has to be provided for all Dissenting Investors. The Consultation Paper states that the, "*value at which the aforementioned exit is proposed to be provided to Dissenting Investors, along with the valuation carried out by two independent valuation agencies, shall be disclosed to all investors*". Though the Consultation Paper does not spell it out in as many words, in our view, even if the valuation arrived at by two independent valuation agencies is higher than the value offered by the bidders or, in the absence of bids, the IBBI Liquidation Value, the transfer of the unliquidated investments can take place at the lower value provided a full disclosure is made to the investors.

Though the Consultation Paper does not expressly say so, it is clear that, the AIF should make best efforts to obtain bids for a minimum of 25% of the unliquidated investments before seeking investor consent for the proposal to transfer unliquidated investments to a new scheme. This is because investors in the AIF would need to know the value of bids received (or if there are no bids, the IBBI Value), before deciding whether to consent to the proposal or not.

Payment to Dissenting Investors

The Consultation Paper does not expressly state when the Dissenting Investors should be paid for their units in the AIF. If bids are received for 25% of unliquidated investments, it would be possible to pay the Dissenting Investors prior to or simultaneously with the transfer of the unliquidated investments from the old scheme to the new scheme. If no bids are received and Dissenting Investors are to be paid at the IBBI Liquidation Value, where would the money to pay the Dissenting Investors come from? Should the AIF somehow dispose of a portion of the unliquidated investments to generate the monies needed to pay the Dissenting Investors? Do remember, this would be a scenario where despite the best efforts of the AIF and its Investment Manager, bids could not be obtained for even 25% of the unliquidated investments.

When the unliquidated investments are transferred from the old scheme to the new scheme, would the old scheme be paid for such transfer? The Consultation Paper is silent on this point. Since atleast 75% of the investors in the old scheme should have consented to the transfer, such investors would become investors in the new scheme and such investors would not pay cash to the new scheme for their units. They would instead swap the units of the old scheme for units of the new scheme and new scheme would not receive any cash from its investors. It is possible that all the investors in the new scheme were investors in the old scheme. If some of the investors in the new scheme are from the old scheme and the rest are not, the new scheme would have a cash corpus which could be paid to the investors in the old scheme to provide them a partial exit. Alternatively, such new corpus could also be deployed in fresh investments.

The new scheme would need some cash for its operating expenses. Can the cash balance from the old scheme be transferred to the new scheme? Presumably yes, though the Consultation Paper is silent on this point.

If bids were not received for 25% of unliquidated investments and the Dissenting Investors couldn't be paid for their units prior to the transfer of the unliquidated investments, the cash consideration paid to the old scheme by the new scheme, if any, could be used to pay the Dissenting Investors. However, it is possible that such cash consideration may not suffice to pay the Dissenting Investors at the time of transfer of the unliquidated investments.

Mid-way cancellation of the plan

If the Investment Manager does not like the bids received for 25% of unliquidated investments, can the Investment Manager cancel the proposed transfer of the unliquidated investments to a new AIF? Would the Investment Manager be required to inform the investors of the bids received even if the Investment Manager does not wish to transfer of the unliquidated investments to a new AIF? The Consultation Paper is silent on these points.

Computing the performance of the AIF's Investment Manager

The Consultation Paper also provides that the performance of the AIF's Investment Manager shall be computed in accordance with the value at which investors are provided exit or the IBBI Liquidation Value, as the case may be. Such performance data shall also be included in the track record of the Investment Manager in the private placement memorandum ("**PPMs**") of subsequent schemes.

Disclosures to new investors

The Consultation Paper requires that fresh investors in the new scheme should be explicitly informed that the new scheme holds unliquidated investments from a previously closed scheme and the reasons thereof. It is presumed that this disclosure will be contained in the PPM of the new scheme.

Proposed exemptions for new schemes

The Consultation Paper provides that if a new scheme is being launched with the objective to only transfer unliquidated investments from old scheme, and not to make any new investment, then such scheme shall be exempted from the following provisions of the AIF Regulations:

a) **Minimum scheme corpus requirement** [Regulations 10(b) and 19L(1)]**:**
Regulation 10(b) of the AIF Regulations provides that each scheme of an AIF shall have a corpus of at least twenty crore rupees. Regulation 19L(1) provides that each scheme of a special situation fund shall have a corpus as may be specified by SEBI. Exemption from these provisions would mean that the new scheme would not be required to have the prescribed minimum corpus and even if the value of the unliquidated investments from the old scheme is less than the prescribed minimum corpus, the AIF would not be in breach of Regulation 10(b) or Regulation 19L(1) of the AIF Regulations. It is interesting to note that the Consultation Paper does not include Regulation 19D(2) in the list of exempt regulations. Regulation 19D(2) of the AIF Regulations prescribes a minimum corpus of five crore rupees for an Angel Fund.

b) **Minimum investment requirement from investor in scheme of AIF (**Regulations 10(b) and 19L(2))**:** Regulation 10(b) of the AIF Regulations provides that an AIF shall not accept from an investor, an investment of value less than one crore rupees. Regulation 19L(2) provides that a special situation fund shall accept from an investor, an investment of such value as may be specified by the Board. Exemption from these provisions would mean that the new scheme may accept an investment of any value from its investors. Therefore, an AIF which launches a

new scheme with the objective to only transfer unliquidated investments from an old scheme would find it easy to raise funds. It is interesting to note that the Consultation Paper does not include Regulation 19D(3) in the list of exempt regulations. Regulation 19D(3) of the AIF Regulations prescribes a minimum investment of twenty five lakh rupees from each angel investor in an Angel Fund.

c) **Requirement of fixed tenure** [Regulation 13(1)]:

Regulation 13(1) of the AIF Regulations provides that Category I AIF and Category II AIF shall be close ended and the tenure of fund or scheme shall be determined at the time of application, provided that such AIFs or schemes launched by such AIFs shall have a minimum tenure of 3 years. Exemption from this provision implies that a scheme which has been launched with the objective to only transfer unliquidated investments from an old scheme need not declare its tenure upfront in its PPM and may be wound down as soon as it fulfils its objective of liquidating/distributing the unliquidated investments of the old scheme.

d) **Investment concentration norms** [Regulation 15(1)(c)]:

Regulation 15(1)(c) of the AIF Regulations provides that Category I and II of AIFs shall invest not more than 25 % (twenty-five per cent) of the investable funds in an Investee Company directly or through investment in the units of other AIFs. The rationale for this exemption is amply clear since the 'unliquidated investments' of the new scheme may consist of less four investee companies. Also, one or more of such 'unliquidated investments' may hold more than 25% of the corpus of the new scheme.

Sequence of actions for transfer of unliquidated investments to a new scheme

Therefore, the sequence of actions would be as follows:

1. Make best efforts to arrange bids for a minimum of 25% of the unliquidated investments;
2. Obtain a valuation for the unliquidated investments from two independent valuation agencies;
3. Disclose to all investors:
    a. the value at which the exit is to be provided, either based on the bids obtained, or on the basis of the IBBI Liquidation Value; and
    b. the valuation for the unliquidated investments determined by two independent valuation agencies;
4. Obtain the consent of not less than 75% of the investors by value of their investments for the proposed transfer to the new scheme;
5. Provide an exit for all Dissenting Investors by selling a suitable portion of the unliquidated investments;
6. Transfer the balance portion of the unliquidated investments to the new scheme; and
7. Pay the old scheme for the unliquidated investments in cash using the contributions received from the investors in the new scheme or swap the units of the old scheme for units or the new scheme or apply a combination of these.

How would the proposals work in real life?

Let's take two examples:

Example A: A Category 1 Infrastructure Fund ("**Infra Fund**") which invested in a number of infrastructure companies each of which owns or have concessions /rights in high value infrastructure projects such as toll roads, solar power projects, wind farms etc. At the end of the original term of eight years, the AIF could not exit from three of its investments. The investors consented to extend the term of the AIF by two years and in those two years, two exits were secured and one 100% investment in a company that owns a concession to operate a toll road ("**Toll Road Company**") remains unliquidated. NHAI's approval is required for any sale of the shares of the toll road company or any change in control of the toll road company; and

Example B: A Category 2 Fund ("**PE Fund**") which made a number of Series B and Series C investments in growth stage companies. At the end of the original term of seven years, the AIF could not exit from six of its investments. The investors consented to extend the term of the AIF by two years and in those two years, two more exits were secured and investments in four investee companies are still held by the AIF.

Let's assume SEBI's afore-mentioned proposals are implemented in their current form. How would the Infra fund and the PE Fund fare under these proposals?

Example A – The Infra Fund

At the end of its term, the Infra Fund may mandatorily liquidate its investment in the toll road company at liquidation value within a year of expiry. Alternatively, the Infra Fund's Investment Manager may set up a new fund ("**New Infra Fund**") and transfer the shares of the Toll Road Company to the New Infra Fund. Before effecting such transfer, the Infra Fund's Investment Manager would have to obtain the consent of 75% of the AIF's investors by value. Investors who do not consent to such transfer of the unliquidated investment to the New Infra Fund have to be given an exit. The Consultation Paper states that the Infra Fund or its Investment Manager has to attempt to arrange bids for a minimum of 25% of the unliquidated investments. In this example, there is only one unliquidated investment. Does this mean the Infra Fund or its Investment Manager should attempt to arrange bids for 25% of the total equity share capital of the Toll Road Company? If the Infra Fund or its Investment Manager are unable to so arrange such bids, the IBBI Liquidation Value may be calculated.

Investors in the Infra Fund shall be provided the following information and invited to either consent to the transfer of the Toll Road Company to the New Infra Fund or seek an exit.

a. the value at which the exit is to be provided, either based on the bids obtained, or on the basis of the IBBI Liquidation Value; and
b. the valuation for the unliquidated investments determined by two independent valuation agencies

In order to provide an exit to dissenting investors, a suitable percentage of the shares of the Toll Road Company would have to be sold. If 25% of the investors of the Infra Fund did not agree to the proposal to transfer the shares of the Toll Road Company to the New Infra Fund, it would be necessary to sell 25% of the shares of the Toll Road Company before 75% of the shares of the Toll Road Company are transferred to the New Infra Fund. If only 5% of the investors of the Infra Fund did not agree to the proposal to transfer the shares of the Toll Road Company to the New Infra Fund, only 5% of the shares of the Toll Road Company would have to be sold after which 95% of the shares of the Toll Road Company can be transferred to the New Infra Fund.

It should be remembered that holders of 26% of the equity shares of the Toll Road Company would be able to block special resolutions moved by the management and so a 26% stake (or a stake which is one equity share more than 25%) would be a lot more valuable than a mere 25% stake since the holders of a 25% stake would not be able to block special resolutions. For this reason, it would be rather difficult to sell any stake not exceeding 25% of the Toll Road Company. Any person who holds more than 50% of the equity shares of the Toll Road Company would control the Toll Road Company. Any person who holds 75% of the equity shares of the Toll Road Company would not only control the Toll Road Company, but also be able to push forward special resolutions without any opposition. For this reason, a 75% stake would be almost as valuable as a 100% stake and cost almost the same.

Bearing in mind that the Infra Fund was unable to exit its investment in the Toll Road Company, it is very likely that when its investors are asked to choose between moving to a new scheme or receiving an exit, they are likely to choose the latter. This decision would, to an extent, depend on

the price being offered for the Dissenting Investors and the value of the Toll Road Company as determined by the two independent valuers. Let's assume 25% of the investors in the Infra AIF (by value of their investments) choose to dissent and seek an exit, how would the Infra AIF generate the funds to redeem the units of the Dissenting Investors? As mentioned earlier, it is very unlikely that the Infra AIF would find a buyer for 25% of its shares. Even if it finds a buyer, it would have to obtain NHAI's approval before the transfer of 25% of its shares can be completed. It is much more likely that the Infra AIF would find a buyer for its entire (100%) equity shareholding in the Toll Road Company. However, even the transfer of the shares of the Toll Road Company to a new scheme with new investors would require the approval of NHAI. Assuming the Investment Manager of the Infra AIF manages to persuade a bunch of new investors to invest a new AIF into which the Toll Road Company is to be transferred, NHAI's approval would be required before the sale can take place.

Assuming the Infra Fund finds a buyer willing to buy all its shares in the Toll Road Company and such buyer makes a formal bid for a 100% stake in the Toll Road Company, it may be possible for the Investment Manager of the Infra Fund to persuade all investors of the Infra Fund to consent to the transfer of the shares of the Toll Road Company to the New Infra Fund, on the understanding that as soon as NHAI's approval is received, the New Infra Fund would sell all shares of the Toll Road Company to the buyer and pass on such exit proceeds to its investors.

Example B – The PE Fund

In order to transfer the shares of the four investee companies to a new PE Fund ("**New PE Fund**"), the PE Fund's Investment Manager would have to obtain the consent of 75% of the PE Fund's investors by value. Investors who do not consent to such transfer of the unliquidated investments to the New PE Fund have to be given an exit, for which the PE Fund or its Investment Manager has to attempt to arrange bids for a minimum of 25% of the unliquidated investments. In this example, there are four unliquidated investments and let's assume there are of roughly equal value. Therefore, the PE Fund's Investment Manager should arrange bids one of the investee companies. If the PE Fund or its Investment Manager are unable to so arrange such bids, the IBBI Liquidation Value of one of the investee companies may be calculated. It is more likely that the four investee companies would not be of equal value. Therefore, the PE Fund's Investment Manager should arrange for bids for a suitable investee company ("**Selected Investee Company**") whose value is average or above average. If the PE Fund or its Investment Manager are unable to so arrange such bids, the IBBI Liquidation Value may be calculated for the Selected Investee Company. The valuation of the Selected Investee Company should also be determined by two independent valuation agencies.

If 25% of the investors of the PE Fund are Dissenting Investors, it would be necessary to sell the shares of the Selected Investee Company before the shares of the other three investee companies are transferred to the New PE Fund. If only 5% of the investors of the PE Fund are Dissenting Investors, only 20% of the shares of the Selected Investee Company would have to be sold after which the rest of the shares of the Selected Investee Company and all other shares of the other three investee companies can be transferred to the New PE Fund. As mentioned earlier, the value of 100% of the shares of the Selected Investee Company would be a lot more than four times the value of 25% of the shares of the Selected Investee Company. Therefore, even if bids were obtained for 100% of the shares of the Selected Investee Company, it is likely that the bidders would outright refuse to buy 25% of the shares of the Selected Investee Company. Even if the bidders are willing to buy 25% of the shares of the Selected Investee Company, they are unlikely to do so at the valuation at which they were willing to buy 100% of the shares of the Selected Investee Company. In such a situation, the PE Fund's Investment Manager may have to arrange fresh bids for a 25% stake in the Selected Investee Company. However, at this juncture, the percentage of Dissenting Investors may change further.

However, it is much more likely that the PE would succeed in offering an exit to its Dissenting Investors than the Infra Fund.

Rolling over investments under extant SEBI AIF Regulations

It is interesting to note that the extant SEBI AIF Regulations do not expressly prohibit an AIF from acquiring the unliquidated investments held by another AIF even if the Investment Manager and/or sponsor of the two AIFs are the same. Rather, it is very much possible for the Investment Manager and/or sponsor of an AIF which is nearing the end of its life term to set up a new AIF and to have the new AIF acquire all of the investments of the AIF whose tenure is about to expire, provided adequate disclosures are made in the PPM of the new AIF. The disclosures that may have to be made in the PPM of the new AIF as per the PPM formats prescribed by SEBI's circular dated February 5, 2020 are as follows:

(a) Section III of the PPM format for Category I and Category II AIFs requires disclosures regarding the proposed AIF's investment strategy and investment philosophy. Therefore, the fact that the unliquidated investments of a previous AIF are proposed to be purchased by such AIF after its initial closing need to be disclosed in this section. Further, the current valuation of the unliquidated investments sought to be transferred from the old AIF and the methodology adopted to reach such valuation should be disclosed upfront to the investors. The investors should also be informed of the valuation methodology that would be applied to calculate the price at which such unliquidated investments would be transferred to the new AIF.

(b) Section IX of the PPM format provides for disclosures regarding all potential sources of conflicts of interests that the Investment Manager envisages during the operations of the Fund/Scheme have to disclosed under this section. This section should highlight that the same person (i.e., the Investment Manager of the old and new AIF) shall make the investment decision of the seller as well as the buyer, with respect to the investments being transferred to the new AIF.

(c) Section X of the PPM format provides for disclosures regarding ***Risk Factors***: This section should lay down as exhaustively as possible all potential risk factors that the investors needs to be aware of in respect of their investments in the Fund/Scheme, including risk associated with the nature of the portfolio investments (type of company, type of instrument, pricing, non-controlling stake/minority interest, as may be applicable) and risk related to the exit of the Fund/Scheme from the portfolio investments and possibility of distribution in kind. Under this section, it may be prudent to disclose the fact that the old AIF was unable to liquidate the investments, which are being bought by the new AIF, and perhaps also the market conditions which caused such inability to liquidate the said investments.

So, what's new that's being proposed by SEBI's Consultation Paper? Under existing law, if a few investments from an AIF nearing the end of its life term are proposed to be transferred to a newly set up AIF, the new AIF would still have to comply with the (i) minimum scheme corpus requirement (Rs. 20 Crore), (ii) the minimum investment requirement from each of its investors (Rs. 1 Crore), (iii) the requirement of having a fixed tenure and (iv) investment concentration norms, all of which are proposed to be disapplied for roll-over AIFs as per the Consultation Paper.

The Lurking Capital Gains Tax Trap

If an AIF sells the shares of a listed company after having held it for atleast twelve months or shares of an unlisted company after having held it for atleast twenty-four months, capital gains, if any, would be taxed at the long-term capital gains rate. If an AIF sells an investment after having held it for less than the period specified for such investment to qualify as a long-term capital asset, capital gains, if any, would be taxed at the short-term capital gains rate.

Long-term capital gains are charged to tax at the rate of 10% (ten percent)[3] for listed securities and 20% (twenty percent), for unlisted securities, plus surcharge and cess as applicable. Short term capital gains arising out of the transfer of unlisted securities are charged to tax at the slab rate applicable to the relevant investor. The income tax slabs vary from 5% (five percent) to 30% (thirty percent) plus surcharges and applicable cess.

When transferring unliquidated investments to a new Fund and when the New AIF exits from the investment, it is more likely that short term capital gains tax would be payable. However, investors in AIFs would have budgeted to pay long terms capital gains and calculations around potential IRR[4] would have been based on the investments.

SEBI's position on extending the term of an AIF:

The Urban Infrastructure Venture Capital Fund example

SEBI has consistently taken the position that the term of a close-ended AIF cannot be extended even with the consent of its investors, unless it is an LVF. Recently in the case of ***Urban Infrastructure Venture Capital Fund***[5], SEBI through its order dated October 31, 2022 directed a venture capital fund to wind up its scheme and provide an exit to its investors. Urban Venture Capital Fund ("**UIVCF**") had been set up in the nature of a trust and was registered with SEBI as a Venture Capital Fund ("**VCF**"). The settler of the VCF was Urban Infrastructure Venture Capital Limited ("**UIVCL**") and the trustee of the VCF was Urban Infrastructure Trustees Limited ("**UITL**"). SEBI conducted an inspection on UIVCF in February 2021 and noted that even though the term of the scheme floated by UIVCF ("**Scheme**") (including extensions) had expired on June 7, 2015, investments amounting to INR 1060.92 crore were yet to be liquidated by the Scheme and to be repaid to investors. On an examination of SCORES[6], it was noted that three complaints had been received against the Scheme, two of which alleged that the Scheme had not been wound up and the investor's capital contribution had not been refunded. Based on this, SEBI issued a show cause notice to UIVCF as to why suitable direction should not be passed against the trustee and Investment Manager of UIVCF for violation of Regulation 23(1)(a) of the SEBI Venture Capital Funds Regulations, 1996 ("**VCF Regulations**").

It is to be noted that the VCF Regulations were the precursor to the AIF Regulations and Regulation 23(1) of the VCF Regulations is similar to Regulation 29(1) of the AIF Regulations. Regulation 23(1) of the VCF Regulations provides that a scheme of a VCF set up as a trust shall be wound up when the period of the scheme, if any, mentioned in the PPM is over. However, unlike in the case of the AIF Regulations, the VCF Regulations do not provide for any extension of the term of a VCF even with the consent of investors.

In response to the show-cause notice, UIVCL and UITL, in their common reply dated June 25, 2021 submitted that due to several impediments such as global financial crisis, delay and slow moving regulatory approval, short funding from developers, high interest rates and construction cost etc., by the end of the tenure of the Scheme in June 2015, the Scheme could return only Rs 621 crore (25.5% of the fund corpus) to the investors. Further, the agency engaged by them to expedite exit was of the view that any effort to sell investments within fixed timelines

[3] For capital gains exceeding Rs. 1,00,000. For capital gains not exceeding Rs. 1,00,000 arising from the sale of listed securities capital gains tax is 20%.

[4] IRR stands for "internal rate of return". IRR is a financial metric used to measure the profitability of an investment and it represents the discount rate at which the present value of future cash flows from the investment equals the initial investment. In other words, IRR is the rate at which the net present value (NPV) of the investment becomes zero. If the IRR is greater than the required rate of return, the investment is considered profitable. Conversely, if the IRR is less than the required rate of return, the investment is considered unprofitable.
IRR is often used by investors to compare different investment opportunities and determine which investment is the most profitable.

[5] WTM/SM/AFD-1/AFD-1-SEC/20965/2022-23.

[6] SEBI's online portal for investors' complaints redressal.

would cause severe erosion in value and that it expected the market conditions to improve later. Hence, the investment manager decided that liquidation of investments or in-specie distribution of investments would result in substantially depressed realization from the investments and were not in the interest of the investors. Thereafter, consent of more than 75% of the investors was obtained, for extension of the tenure of the Scheme till December 31, 2016. The Scheme distributed a further amount of INR 632 crore to its investors from June 2015 till December 2016. Since then, UIVCF had made numerous efforts to liquidate the assets of the Scheme including exploring the possibility of in-specie distribution amongst the investors. However, UIVCF faced a lot of impediments in the form of demonetization (in November 2016), implementation of Real Estate (Regulation and Development) Act, 2016 and introduction of Goods & Services Tax (in 2017), litigation, Covid-19 etc. due to which UIVCF was unable to liquidate its assets. Despite all this, the Scheme was able to distribute an additional INR 701 crore to investors till July 2018. It was submitted that since 2017, the Scheme had been in liquidation stage for orderly exit as per the PPM.

SEBI ruled that it would not be an appropriate interpretation of the law to state that a scheme that had invited investors to invest in the fund promising it to have a definite lifespan, could be permitted to continue to exist in perpetuity only on the ground that any exit that may be provided to the unit holders, may not be profitable to them at the time of their exit. SEBI opined in its order that the PPM contained disclosures of adequate and material risk factors and the investors in the Scheme were sophisticated (individual investment of minimum Rs.1 crore or more). Thus, it was reasonable to infer that they had invested in the Scheme knowing very well the associated risks involved in a real estate scheme and were aware that there was a possibility of loss. SEBI order required UIVCF, UIVCL and UITL to ensure that the Scheme is wound up by providing exit to its investors within a maximum period of 3 months from the date of its order.

SEBI sticks to its guns

This Consultation Paper has once again reiterated that SEBI is unwilling to allow any extension of a close-ended AIF's prefixed tenure beyond two years. In most cases, an AIF's investments remain unliquidated since the Investment Manager is unable to find a buyer for such investment at an acceptable price. Distribution of such investments in-specie is not a feasible option since such distribution would result in investors of the AIF receiving very small stakes of the investee company, which would be very difficult, if not impossible to sell.

Should SEBI reconsider its position?

Should SEBI consider the option of permitting AIFs to extend their tenure with the unanimous approval of all investors? Doing so would solve the dilemma of many an Investment Manager, though it would vitiate the solemn commitment to windup the AIF/scheme provided at the time of setting up the AIF/scheme.

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