

PROPOSED FLEXIBILITY FOR AIFs IN WINDING-UP OF SCHEMES AND SURRENDER OF REGISTRATION

The Securities and Exchange Board of India (“SEBI”), through [its consultation paper dated February 5, 2026](#), has proposed amendments to the SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”) to introduce flexibility in the winding-up process of alternative investment funds (“AIF”) schemes and surrender of registration.

The proposal seeks to permit limited retention of liquidation proceeds beyond the permissible fund life in specified circumstances, while introducing an ‘inoperative AIF’ classification to rationalise compliance requirements during the winding down phase. The objective is to balance operational practicality with investor protection.

A. BACKGROUND:

Under Regulation 29(7) of the AIF Regulations, an AIF scheme is required to liquidate its assets and distribute proceeds to investors within one year from the expiry of its tenure. Further, surrender of AIF registration requires confirmation of full liquidation and maintenance of a NIL bank balance.

In practice, AIFs nearing closure may face residual exposures arising from: (a) pending litigation or tax demands, (b) anticipated litigation or tax contingencies, and (c) operational liabilities such as audit costs or statutory expenses.

Even minor retained amounts have prevented surrender of registration, resulting in prolonged compliance burdens for otherwise defunct funds. The consultation paper proposes to address this structural rigidity.

B. SALIENT FEATURES OF PROPOSED FRAMEWORK:

PARTICULARS	DETAILS				
Constraint under the existing framework	Regulation 29(7) of the AIF Regulations, 2012 strictly requires full liquidation of assets and distribution of all proceeds to investors within the 1-year liquidation period (post-tenure expiry), along with proof of NIL bank balance for surrender applications. This blocks registration surrenders for funds with even small unresolved amounts.				
Permitted Circumstances: Applicability and Safeguards (Proposed)	<p>The proposed relaxation would apply to AIFs and VCFs that have completed their tenure (including any permitted extensions) but have retained monies due to:</p> <p>A. Pending litigation or tax demands:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 20%;"><u>Applicability</u></td> <td>Where a formal notice has been received from a court, regulatory authority, tax authority, or law enforcement agency.</td> </tr> <tr> <td><u>Safeguards</u></td> <td>This will require demonstration of receipt of litigation or demand notice</td> </tr> </table>	<u>Applicability</u>	Where a formal notice has been received from a court, regulatory authority, tax authority, or law enforcement agency.	<u>Safeguards</u>	This will require demonstration of receipt of litigation or demand notice
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Investor Protections	<ul style="list-style-type: none"> • Investor approval (75% by value) is required only for anticipated liabilities. • No investor approval is required where a formal notice has already been received. 										
Other Proposed Conditions	<p>The AIF may be classified as an 'Inoperative AIF' during this interim period, with proportionate compliance rationalization. The proposed framework imposes the following conditions:</p> <ul style="list-style-type: none"> • No new investments or portfolio management activity post-tenure. • Retained monies must be invested only in accordance with Regulation 15(f) of the AIF Regulations • Clear substantiation of operational expenses. • Annual reporting to SEBI and investors regarding: <ul style="list-style-type: none"> (a) Amount retained, (b) Purpose of retention, (c) Status of underlying liability. • Maximum retention period of three years for amounts retained towards operational expenses. • No charging of management fees during the retention phase. 										
Industry Objective	The proposal aims to address industry feedback regarding compliance hurdles faced by dormant or matured AIFs. If										

implemented, it may enable quicker closure, efficient capital recycling, and support growth of the AIF ecosystem while maintaining regulatory oversight.

C. INOPERATIVE AIFs

INOPERATIVE AIFs	
Classification as Inoperative AIFs	<p>SEBI proposes to introduce an ‘Inoperative AIF’ category covering:</p> <ul style="list-style-type: none"> • AIFs having two or more schemes where funds are retained beyond permissible fund life; and • AIF not retaining monies beyond permissible fund life but may continue to exist in anticipation of a future inflow.
Regulatory Framework for inoperative AIFs (Proposed)	<ul style="list-style-type: none"> • Rationalized compliances: Discontinuation of PPM audit report, CTR report and quarterly filing to SEBI; • Annual status reporting to SEBI and investors regarding retained monies; • Investment of retained monies strictly in accordance with Regulation 15(f) of the AIF Regulations; • Prohibition on launch of new schemes; • Prohibition on charging management fees; • Maximum retention period of 3 (three) years for amounts retained towards operational expenses.
Efficient Exit via Inoperative Status	<ul style="list-style-type: none"> • <u>Continued Eligibility for Surrender of Registration</u>: An AIF may surrender its registration upon full distribution of liquidation proceeds and maintenance of a NIL bank balance. • <u>Interim Inoperative Status</u>: The proposed ‘inoperative’ classification creates an interim regulatory status allowing limited retention of monies with rationalised compliances, enabling a more cost-efficient and structured exit process.

D. ANALYSIS OF THE PROPOSALS

PROPOSAL 1: EXTENDING FUND LIFE FOR RETAINED FUNDS

Pros:

- *Recognizes practical realities of litigation and tax timelines*
- *Introduces investor consent mechanism for anticipated liabilities.*
- *Reduces need for premature distributions.*

Considerations:

- *75% majority approval may prejudice minority investors.*
- *No express mechanism for segregated escrow or dissent protections.*
- *Clear guidance on quantum justification may be necessary to prevent excessive retention.*

PROPOSAL 2: PRESCRIBING SPECIFIC OPERATIONAL EXPENSE HEADS

Pros:

- *Brings clarity and limits interpretational ambiguity.*
- *Prevents indefinite retention under broad expense heads.*

Considerations:

- *Overly rigid categories may exclude legitimate expenses.*
- *Preferable to combine defined heads with principles-based flexibility.*

PROPOSAL 3: TAGGING AIFS WITH RETAINED MONIES AS “INOPERATIVE”

Pros:

- *Provides a sensible mechanism to pause operations while resolving liabilities.*
- *Avoids premature surrender of registration.*
- *Enables proportionate compliance relief with continued SEBI oversight.*

Considerations:

- *Reduced compliance should not dilute supervision.*

PROPOSAL 4: ‘INOPERATIVE’ STATUS FOR FUNDS WITHOUT RETAINED MONIES

Pros:

- *Pragmatic tool for dormant AIFs awaiting contingent inflows.*
- *Reduces unnecessary compliance burden.*
- *Broadens regulatory coverage of inactive structures.*

Considerations:

- *Risk of indefinite dormancy without viability checks. Specific period of dormancy to be mentioned.*
- *Periodic certification of continued relevance may be useful.*

PROPOSAL 5: FRAMEWORK FOR INOPERATIVE FUNDS

Pros:

- *Balanced compliance rationalisation.*
- *Safeguards via management fee prohibition and restriction on new schemes.*
- *Three-year cap for monies retained towards operational expenses discourages prolonged retention*

Considerations:

- *SEBI may consider conditional extension of the three-year period with safeguards.*

E. CONCLUSION

Overall, SEBI's proposed framework represents a pragmatic and forward looking reform that meaningfully addresses practical challenges faced by matured and dormant AIFs. The proposed move towards permitting limited fund retention, introducing the "inoperative" classification, and rationalising compliances reflects a balanced attempt to enhance ease of doing business while preserving investor protection and regulatory oversight. Subject to stakeholder feedback and targeted refinements, the proposals appear directionally sound.

• **MUMBAI**

📍 The Capital, B/513, Bandra Kurla Complex, Bandra (East), Mumbai, Maharashtra 400051

☎ (+9122) 40049800 | 40049801
✉ communications@begurs.com

• **BENGALURU**

📍 236 Sumitra, 2'C Cross, 1st Main Rd, 2nd Stage, Domlur, Bengaluru, Karnataka 560071

☎ (+91-80) 4123 9800 | 40936801
✉ communications@begurs.com

• **UAE**

📍 A4-115, Building No. A4, Al Hamra Industrial Zone – FZ, RAK – United Arab Emirates.

☎ (+971) 502234052
✉ communications@begurs.com



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