Investment Funds: Monthly Digest

April 30, 2024

DECODING AIF DISSOLUTION: ANALYSIS OF THE DISSOLUTION PERIOD FRAMEWORK

- SEBI introduces Dissolution Period framework for AIFs to manage unliquidated investments.
- AIFs are no longer permitted to launch liquidation schemes.
- Dissolution Period to initiate, subject to investor consent and other procedural requirements, post the liquidation period for a period not greater than the original tenure of the AIF.
- Mandatory in-specie distribution upon expiry of Dissolution Period.

In response to numerous industry representations regarding the practical issues faced by Alternative Investment Funds (**"AIFs"**) in liquidating their investment portfolio within the tenure specified in the private placement memorandum (**"PPMs"**), the Securities and Exchange Board of India (**"SEB**
framework wherein an AIF was able to transfer its unliquidated investment to a separate scheme.

However, this liquidation scheme framework was saddled with practical difficulties. We had undertaken an in-depth analysis of the liquidation scheme framework here. To address the industry's concerns, SEBI had released a consultation paper proposing a dissolution period framework wherein
be allowed to extend their tenure beyond the limit specified in their PPM. Our in-depth analysis of the consultation paper on dissolution period is available here.

SEBI has now promulgated the SEBI (AIF) (Second Amendment) Regulations, 2024 (**"AIF Amendment"**) and issued a circular on 'Flexibility to AIF and their investors to deal with unliquidated investments of their schemes'[1] (**"Dissolution Circular"**) providing a revised framework for AIFs to better
and replacing the erstwhile liquidation scheme framework.

In this issue of the monthly digest, we examine the AIF Amendment and the Dissolution Circular.

WHAT HAPPENS TO LIQUIDATION SCHEMES?

The AIF Amendment provides that-

- AIFs are not permitted to launch a liquidation scheme post April 25, 2024; and
- Existing liquidation schemes shall continue to be governed by the provisions of the SEBI (AIF) Regulations, 2012 (**"AIF Regulations"**) till such schemes are wound up.[2]

WHAT DOES DISSOLUTION PERIOD MEAN?

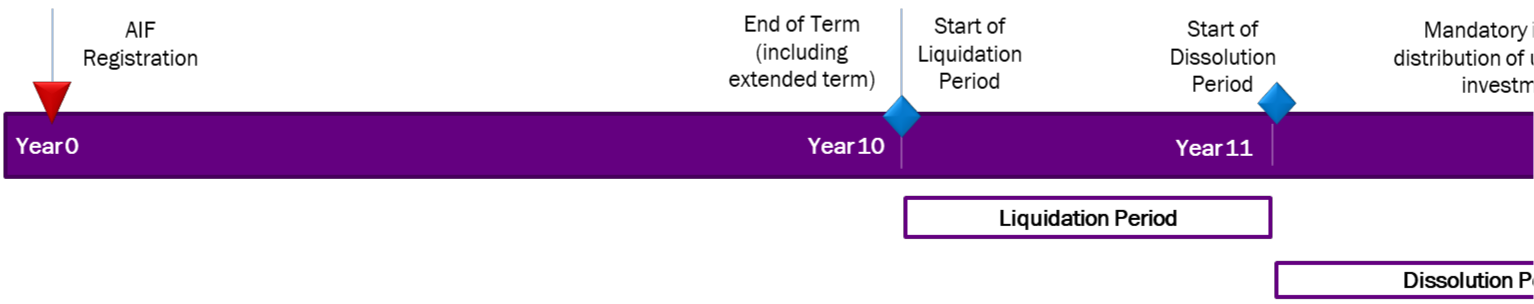

Figure 1: Snapshot of an AIF lifecycle

Dissolution Period has been defined to mean the period which follows the expiry of the liquidation period of the fund for the purpose of liquidating the unliquidated investments of the fund (**"Dissolution Period"**).[3] The timeline of a fund including dissolution period is depicted below.

Procedure for entering Dissolution Period

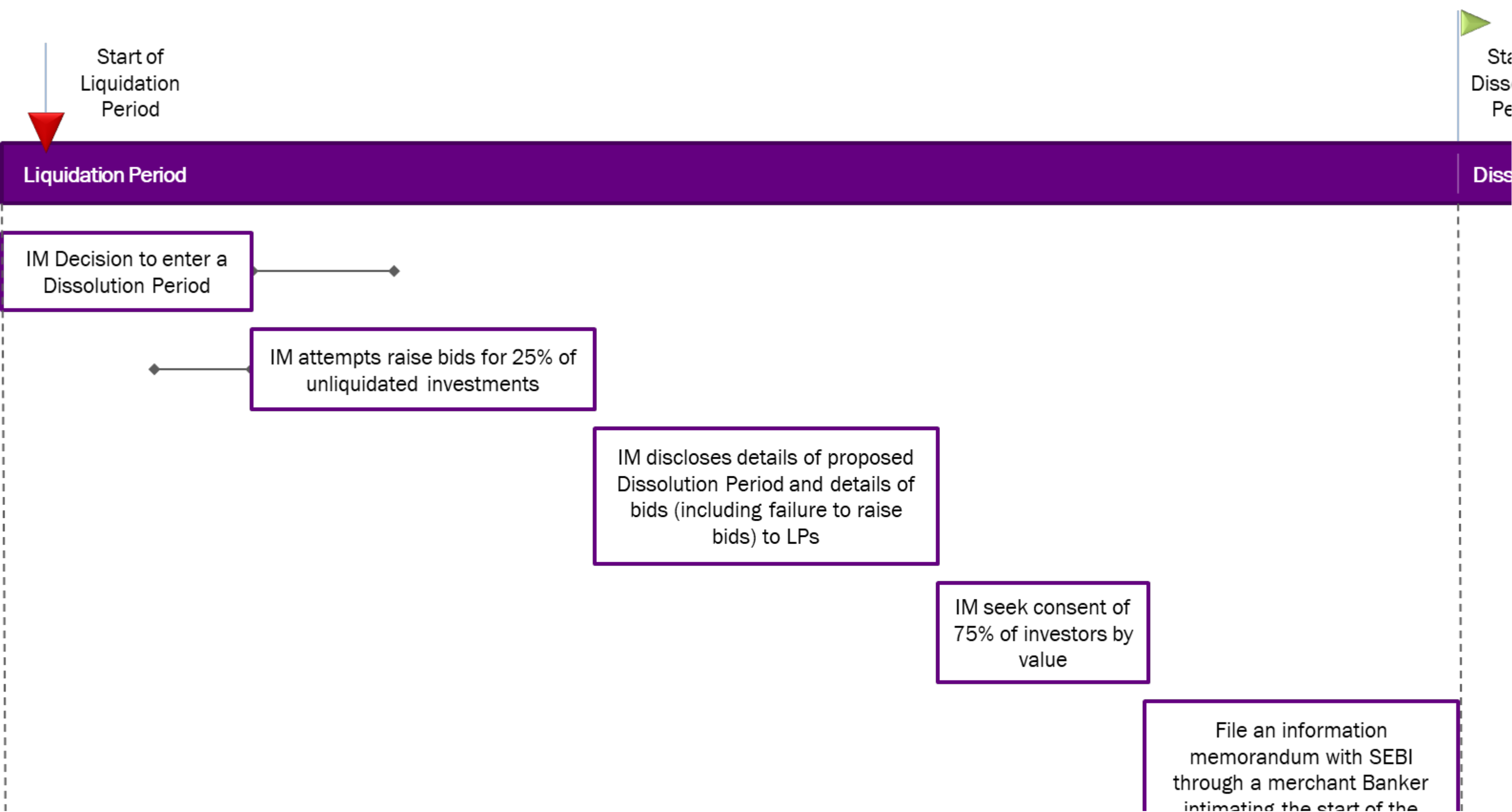

Figure 2: Procedure for entering Dissolution Period

The procedure by which an AIF may enter into a dissolution period during the liquidation period is pictographically provided under figure 2 above. Please note that the modalities of the bidding mechanism remains consistent with that provided under the liquidation scheme framework (the same l
to be noted that the investment manager, trustee and key management personnel of AIF and investment manager are responsible for compliance with the above procedure.

Conditions for entering Dissolution Period

An AIF may enter into a Dissolution Period subject to certain conditions as provided under the AIF Amendment and the Dissolution Circular, which are as follows:

- The scheme is not to accept any fresh commitment from any investor during the Dissolution Period;[4]
- The scheme is to not make any new investment during the Dissolution Period;[5]
- No management fee is charged during the Dissolution Period;[6]
- The tenure of the Dissolution Period is to not be more than the original tenure of the scheme and shall not be extended in any manner upon expiry of the Dissolution Period;[7] and
- The investment manager communicates the value of the unliquidated investments of the scheme to performance benchmarking agencies for appropriately capturing the track record of performance of the manager. Here, the value of such unliquidated investments shall be-
  - Calculated based on the bid value if the investment manager successfully raises bids for a minimum of 25% of the value of unliquidated investments;
  - INR 1, if otherwise.[8]

It may be noted that an AIF may enter into a Dissolution Period even if the investment manager fails to arrange for any bids for its unliquidated investments; provided, however, that the investment manager tries to raise bids for the same and has obtained the requisite investor consent.[9]

Instances where Mandatory In-specie Distribution are Triggered

Certain investors, by way of their internal policies or otherwise, are prohibited from receiving in-specie distribution of assets. Nevertheless, the AIF Regulations provide multiples instances that trigger a mandatory in-specie distribution of unliquidated investments. The same are as follows-

- At the expiry of the liquidation period if the investment manager does not obtain 75% consent of investors by value to enter into a Dissolution Period;[10]
- At the expiry of the Dissolution Period.[11]

Further, the Dissolution Circular clarifies that no further extension or liquidation period shall be available to any AIF/scheme of an AIF after the expiry of Dissolution Period.[12]

CONCLUSION

The dissolution period framework improves upon the liquidation scheme framework by providing a more viable solution for AIFs to manage unliquidated investments. There are no negative tax or regulatory externalities. Further, leeway for funds to internally manage unliquidated investments is i
provides additional comfort to foreign investors as they deal with a more familiar framework of winding up a fund.

The current need of the hour is to include the AIF Standards Setting Forum in templatizing the information memorandum that is to be filed with SEBI for the launch of the Dissolution Period.[13] Herein, it is also recommended that the requirement of filing such an information memorandum through a
the same adds to the operation costs of the winding up at a stage where the fund is under the highest amount of financial stress.

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You can direct your queries or comments to the authors.

[1]Flexibility to Alternative Investment Funds (AIFs) and their investors to deal with unliquidated investments of their schemes, SEBI circular SEBI/HO/AFD/PoD-I/P/CIR/2024/026 dated April 26, 2024

[2]Regulation 29A(8) of the AIF Regulations

[3]Regulation 2(1)(ia) of the AIF Regulations

[4]Regulation 29B(4) of the AIF Regulations

[5]Ibid

[6]Clause 2.3.10 of the Dissolution Circular

[7]Regulation 29B(3) of the AIF Regulations

[8]Clause 2.3.7 of the Dissolution Circular

[9]Clause 2.3.5 of the Dissolution Circular

[10]Clause 3.1.1 of the Dissolution Circular

[11]Clause 2.3.9 of the Dissolution Circular

[12]Ibid

[13]Regulation 29B(2) of the AIF Regulations