

Investment Funds: Monthly Digest

December 01, 2023

HOW DO SIGNIFICANT BENEFICIAL OWNERSHIP DISCLOSURES IMPACT AIFs?

INTRODUCTION

2.3% of the Alternative Investment Funds (“AIFs”) which are registered with the Securities and Exchange Board of India (“SEBI”) have been set up as limited liability partnerships (“LLPs”) under the Limited Liability Partnership Act, 2008 (“LLP Act”).

The recently introduced Limited Liability Partnership (Third Amendment) Rules, 2023 (“Amended LLP Rules”) and the Limited Liability Partnership (Significant Beneficial Owners) Rules, 2023 (“SBO Rules”) may have an impact on such AIFs which are LLPs (“LLP-AIFs”). In this monthly digest piece, we have discussed some noteworthy implications.

ANALYSIS

SBO Rules:

The SBO Rules aims to promote transparency in LLPs and capture the details of the underlying significant beneficial owners (“SBOs”) in such LLPs. The SBO Rules provide the following section on non-applicability:

“ 10. Non-applicability.- These rules shall not apply to the extent the contribution of the reporting limited liability partnership is held by.-

... (c) an investment vehicle registered with. and regulated by the Securities and Exchange Board of India. such as mutual funds, **alternative investment funds (AIF)**, Real Estate investment Trusts (REITs), infrastructure Investment Trust (InViTs)...”

Accordingly, the SBO Rules should not be applicable to an LLP insofar as a partner is an AIF. However, the SBO Rules do not seem to have exempted LLP-AIFs themselves (i.e. where the AIF itself is an LLP) from these enhanced disclosure requirements.

Therefore, in accordance with the SBO Rules,¹ LLP-AIFs may need to take necessary steps to identify their SBOs and cause such SBOs to make the necessary declarations. Further, LLP-AIFs are also now required to maintain a register of SBOs that would be open for inspection by the partners.² It is currently not mandatory for AIFs to disclose information to each of its investor about all the other investors. On the contrary, this type of information sharing is restricted in some cases by AIF investors.

Further, the threshold for disclosures is relatively low (10%) and the determination goes beyond direct to indirect as well. There are thresholds pertaining to significant influence and control as well.

It is also ambiguous as to what would constitute a ‘control’ of financial and operating policy decisions of an LLP-AIF as the sub-committees under the AIF such as the investment committee usually has certain autonomy in determining policies of the AIF. A literal reading of the SBO Rules suggests that investment committee members may be considered SBOs of the LLP-AIF- however, this interpretation seems to differ from the spirit of the SBO Rules. Therefore, additional clarity from the regulators is needed. Additionally, it is generally observed that the investment manager holds less than 10% of the contributions in an AIF. However, it may be noted that the investment manager makes the investment decisions of an AIF and, therefore, may be said to hold ‘significant influence or control’, thus, necessitating the SBO disclosures although such beneficial interest disclosures may have already been provided to SEBI at the time of an AIF’s filing for registration.

Separately, AIFs are already subject to stringent KYC requirements by virtue of their status as registered intermediaries with SEBI. The intent of the ‘non-applicability’ provision under the SBO Rules indicates a motive to exclude entities that are already regulated by other regulators in this regard. However, due to the current construct of the SBO Rules the ‘non-applicability’ has not been extended to LLP-AIFs- resulting in two co-existing regulatory requirements. Ergo, it may be recommended that this language is amended so as to expressly exempt LLP-AIFs from the ambit of the SBO Rules.

There are certain ambiguities and challenges in terms of – who can legally become the partners of an LLP; how to determine indirect holding and identify an SBO in case of a body corporate / partnership firm / pooled investment vehicle being a partner; voting and profit distribution rights arrangement among the partners; and how ‘control’ and ‘significant influence’ aspects works in view of basic structure of an LLP. An LLP-AIF would also have to face such ambiguities or challenges. For an in-depth analysis of them, please refer to our hotline available [here](#).

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The Amended LLP Rules have:

- Mandated the maintenance of a register of partners; and

This is a common practice among LLP-AIFs and should not considerably impact the operations of the AIF.

- Introduced the concept of a 'Registered Partner' (whose name is entered into the register but does not hold any beneficial interest) and 'Beneficial Partner' (who acquires beneficial interest in the contribution to the LLP).

AIFs issue units to their partners/investors towards the capital contributions made by such partners/investors. Units of an AIF have been defined under the SEBI (AIF) Regulations, 2012 ("AIF Regulations") to mean, "beneficial interest of the investors in the AIF or a scheme of the AIF and may be fully or partly paid up."³, all partners/investors of the LLP-AIF would hold a beneficial interest in it.

There may be situations where a nominee is identified by an investor to receive the distributions on the contributions made by such investor. Such nominee details would be captured in the demat account of the partner/investor itself (where such LLP-AIF units are held by the partner/investor), and the nominee will not necessarily appear on the register of partners of the LLP. Accordingly, this should not operationally impact LLP-AIFs.

The potential to explore using this bifurcation in the context of funds merits consideration. There could be a Registered Partner who is managing the AIF units on behalf of the Beneficial Partner. Such management could include exercising voting rights, reviewing reports, engaging in meetings and discussions etc. It may be relevant for fund-of-fund structures. However, there could be considerable limitations on account of KYC, consideration, liabilities (such as for failure to contribute, confidentiality breach, giveback and indemnities), enforcement of rights and no express framework under AIF Regulations.

For an in-depth analysis of Amended LLP Rules, please refer to our article titled 'Government Strengthens Beneficial Interest Disclosure Regime' available [here](#).

CONCLUSION

The heightened disclosure/compliance obligations cast on LLPs may further deter investment managers/sponsors from structuring AIFs as LLPs. With the recent amendments in the AIF Regulations which, for AIFs set up as trusts, restrict managers from meeting their loss or damage or expenses out of the trust property,⁴ and the rising number of AIFs in India, there is a need for a dedicated corporate form being made available to AIFs.⁵ Efforts have been made (such as setting up a committee and reports being issued) towards considering a variable capital company structure for funds but little or no progress has been made.

— Athul Kumar, Chandrashekar K and Nandini Pathak

You can direct your queries or comments to the authors.

¹Rule 4 of the SBO Rules

²Rule 7 of the SBO Rules

³Regulation 2(y) of the AIF Regulations

⁴Proviso to regulation 25 of the AIF Regulations

⁵Piyush Nagda, AIF industry grows 7 times in 5 years as HNIs scout for diversification, Economic Times

<https://economictimes.indiatimes.com/ markets/stocks/news/aif-industry-grows-7- times-in-5-years-as-hnis-scout- for-diversification/ articleshow/92535193.cms>

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