

Reshaping the AIF Exit Framework: Greater Flexibility in Winding-up Schemes

26 March 2026

Introduction

The Securities and Exchange Board of India (SEBI), at its 213th Board Meeting held on March 23, 2026, approved amendments to the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (AIF Regulations). These amendments aim to address a long-standing operational challenge faced by Alternative Investment Funds (AIFs) in completing the winding-up of their schemes by introducing a framework that provides greater flexibility during the winding-up process.

This newsflash outlines the key features of the approved framework and includes our preliminary observations on the broader implications for AIF managers and investors. A detailed legal analysis will be shared once the final amendments are formally incorporated into the AIF Regulations and the corresponding circulars are issued by SEBI.

Background

Under the extant AIF Regulations, upon expiry of the fund tenure, an AIF is required to liquidate its assets, distribute the proceeds to investors, and ensure that the scheme achieves a NIL bank account balance prior to surrendering its registration. In practice, several AIFs have faced challenges in meeting this requirement due to pending or potential tax liabilities, ongoing litigation, or residual operational expenses. In the absence of regulatory flexibility to address situations involving anticipated or ongoing litigation and tax claims, AIFs were being kept in abeyance beyond their original tenure and were consequently exposed to the risk of regulatory action. Further, even where there is no ongoing fund management activity, such AIFs continue to remain subject to the same reporting and compliance requirements as active AIFs, which can be burdensome for fund managers, particularly in the absence of investment activity.

Key Flexibilities Introduced by SEBI

SEBI has approved amendments to the AIF Regulations to permit retention of liquidation proceeds beyond the permissible fund life, subject to the following conditions:

1. **Demonstrable litigation / tax demand:** Receipt of a formal litigation notice or tax/regulatory demand (including show-cause notices, re-assessment notices, or other official written communications);
2. **Investor consent:** For anticipated liabilities arising out of litigation or tax demands, consent of at least 75% of investors by value is required; or
3. **Operational expense retention:** Retention of amounts for meeting residual operational expenses during the winding-up phase, substantiated through invoices or prior-year comparables, subject to a maximum period of three years from the end of the permissible fund life.

Inoperative Funds: A new categorisation

AIFs that intend to surrender their registration and have one or more schemes falling within the above conditions will be classified as 'inoperative funds'. Such AIFs will be subject to a reduced compliance framework until surrender of their registration certificate. The relaxations are expected to include, among others:

1. Discontinuation of periodic filings;
2. No obligation to update the Private Placement Memorandum; and
3. Exemption from performance benchmarking requirements.

Our Analysis

These amendments are intended to facilitate the orderly winding-up of AIF schemes that retain limited funds for pending or anticipated liabilities, while reducing the compliance burden on AIFs that no longer undertake active fund management activities. The proposed amendments are expected to have a practical and largely positive impact on the AIF industry, particularly for funds nearing the end of their life but unable to fully wind up due to ongoing or anticipated regulatory or tax claims.

Firstly, the framework directly addresses a long-standing operational challenge faced by AIFs at the end of their fund life. Under the earlier regime, funds were required to distribute all proceeds and achieve a NIL bank balance before surrendering their registration. In practice, however, several funds were required to retain limited amounts to address pending or anticipated tax liabilities, ongoing litigation exposure, or residual operational expenses. By permitting retention of proceeds beyond the permissible fund life, subject to specified conditions such as demonstrable regulatory or tax demands, investor consent for anticipated liabilities, or substantiated operational expenses, the new framework introduces greater regulatory clarity and operational flexibility to fund managers during the winding-up phase.

Second, the introduction of the concept of 'inoperative funds' is likely to significantly reduce the compliance burden. At present, even funds with no active investment activity must continue to comply with ongoing regulatory requirements such as filings, disclosures, and updates to fund documents. The ability to classify such funds as inoperative, with a rationalised compliance framework until surrender of registration is expected to reduce unnecessary administrative and regulatory costs while ensuring that appropriate regulatory oversight remains in place.

While this is a welcome move by SEBI and the proposed amendments reflect a more pragmatic and facilitative regulatory approach, balancing ease of compliance for fund managers with continued investor protection, SEBI should also consider covering certain additional scenarios. These include: (i) challenges faced by venture capital funds in distributing the proceeds to untraceable investors; and (ii) situations where venture capital funds that have filed for winding-up on or before March 31, 2025, or AIFs that have already initiated the winding-up process, continue to face pending litigation or tax disputes.

- Vivek Mimani (*Partner*) and Samarth Chopra (*Senior Associate*)



About Khaitan & Co

Khaitan & Co is a top tier and full-service law firm with over 1300+ legal professionals, including 300+ leaders and presence in India and Singapore. With more than a century of experience in practicing law, we offer end-to-end legal solutions in diverse practice areas to our clients across the world. We have a team of highly motivated and dynamic professionals delivering outstanding client service and expert legal advice across a wide gamut of sectors and industries.

To know more, visit www.khaitanco.com



This document has been created for informational purposes only. Neither Khaitan & Co nor any of its partners, associates or allied professionals shall be liable for any interpretation or accuracy of the information contained herein, including any errors or incompleteness. This document is intended for non-commercial use and for the general consumption of the reader, and should not be considered as legal advice or legal opinion of any form and may not be relied upon by any person for such purpose. It may not be quoted or referred to in any public document, or shown to, or filed with any government authority, agency or other official body.

www.khaitanco.com | © Khaitan & Co 2026 | All Rights Reserved.

Ahmedabad · Bengaluru · Chennai · Delhi-NCR · Kolkata · Mumbai · Pune · Singapore