SEBI Proposes to Overhaul Investor Consent Framework and Expand Conflict-of-Interest Safeguards for AIFs

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Background

On 30 June 2026, the Securities and Exchange Board of India (SEBI) issued a consultation paper (Consultation Paper) proposing significant reforms to the existing framework that governs investor consent mechanisms and conflicts of interest under the SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations). The proposed reforms seek to enhance governance standards by introducing a more uniform framework for obtaining investor consent and broadening the scope of conflict-related safeguards applicable to alternative investment funds (AIFs).

(i) The Consultation Paper primarily seeks to address the following regulatory gaps: the absence of a standardised framework for obtaining investor consent, resulting in divergent market practices;

(ii) inconsistent investor approval thresholds under the AIF Regulations, leading to operational complexity; and

(iii) the limited scope of the existing definition of 'associate', which may no longer capture the nature of transactions and relationships involving an AIF and its related parties, including its sponsor, investment manager and key management personnel.

(A) Standardising Mechanism for Obtaining Investor Consent

Currently, the AIF Regulations mandate investor consent for material decisions, including alterations to the investment strategy, in specie distributions, extension of the fund tenure and conflicted transactions. However, the AIF Regulations do not prescribe the manner in which such consent is to be obtained. This lack of regulatory guidance has resulted in divergent market practices, with majority of fund managers relying on the 'deemed consent' mechanism for investors who fail to provide their consent or dissent within the prescribed timelines.

In order to streamline the proposed voting process, SEBI has now proposed a structured framework that would permit AIFs to adopt any one of three prescribed consent methodologies at the scheme or fund level, subject to upfront disclosures and procedural safeguards in the fund documents.

The proposed consent methodologies are as follows:

(i) **Deemed Consent**: Votes cast in favour, together with non-responsive investors, are treated as approvals and calculated against the total value of investors in the AIF;

(ii) **Present and Voting**: Only votes that are actively cast by investors, whether in favour or dissent, are counted. Investors who do not participate in the voting process are treated as having abstained, and such abstentions are excluded from the voting outcome. The approval threshold is calculated based on the value of the participating investors; and

(iii) **Express Voting:** Only affirmative votes from investors are counted towards the approval threshold. Investors who do not cast a vote within the prescribed timeline are treated as having neither consented nor dissented. The approval threshold is calculated against the total fund value.

1. *Need for a standardised investor consent framework*

Each methodology proposed under the Consultation Paper carries distinct implications. The 'deemed consent' approach, for instance, is widely adopted in the industry as it provides greater execution certainty, particularly where a significant number of investors do not respond within the prescribed timelines. This is especially relevant for widely held funds with a large retail investor base, where obtaining express consent or dissent from every investor within the required timelines may be operationally challenging.

On the other hand, in certain cases where the investors do not respond with their vote, in line with global practice, some fund managers adopt the methodology of treating the same as abstentions. Such investors are typically excluded from both the numerator and denominator while calculating the consent percentage.

SEBI has identified that the current practice of applying different consent methodologies to different investors within the same scheme as a governance concern. The proposals under the Consultation Paper are aimed at addressing an observed market practice where certain anchor or institutional investors negotiate express consent rights, while the fund managers continue to apply the deemed consent mechanism to others. This differential treatment has the potential to influence voting outcomes and undermine consistency in investor governance. Accordingly, the proposed framework would require a single consent methodology to be adopted at the scheme or fund level and applied consistently to all investors.

2. *Disclosure and procedural safeguards*

The Consultation Paper prescribes that the chosen methodology, along with the corresponding policies, procedures and associated risks, must be disclosed in the private placement memorandum (PPM). Such disclosures would include the mode of communication with investors, voting procedures, notice periods, and reminder mechanisms.

For each proposal requiring consent, investors must also be informed of the rationale for the proposal, the applicable regulatory or contractual trigger, the relevant approval threshold and the treatment of non-responses. Where the 'deemed consent' methodology is adopted, response timelines must be applied uniformly across all investors.

SEBI has proposed to amend the AIF Regulations by inserting Regulation 20(25) into the AIF Regulations to empower it to prescribe the manner of obtaining investor consent. The detailed operational framework is expected to be set out in a formal circular.

3. *Uniform 75% approval threshold*

The AIF Regulations currently prescribe varying consent thresholds: 66.67% (i.e. two-thirds majority) or 75%, in each case by value of investment in the AIF, for different matters requiring investor approval. SEBI has proposed rationalising this to a uniform 75% threshold for all matters under the AIF Regulations wherever investor consent is mandated. The higher threshold would provide greater protection to minority investors, who may otherwise be dragged along by majority approval.

4. *Grandfathering for existing schemes*

Existing AIF schemes would be grandfathered, meaning they would not be required to retrospectively alter their existing consent methodology. The proposed framework would apply prospectively from its effective date. New schemes, and existing schemes adopting fresh consent policies after that date would need to comply with the revised framework.

5. *Analysis*

While the Consultation Paper indicates the increasing efforts of SEBI to enhance governance norms and provides for procedural certainty, it may cut against the flexibility that is currently afforded in the global market, whereby response timelines and the treatment of non-response are often decided basis the nature and seriousness of the proposed matter. For instance, some significant decisions in relation to the fund (such as extension of final closing and/or replacement of key persons) follow the express voting mechanism; whereas routine or less material matters are often dealt with through deemed consent. Similarly, the Institutional Limited Partners Association (ILPA) Principles 3.0 recommend treating non-responses as abstentions, excluding them from both the numerator and denominator while calculating the approval threshold.

Overall, the Consultation Paper represents a significant strengthening of the AIF governance standards, making it more favourable for the investors of the AIFs, while preserving commercial flexibility within a more transparent and predictable framework. If implemented, AIF managers will need to identify and disclose an appropriate consent methodology in the PPM, apply it uniformly across all investors within a scheme, and maintain clear documentation of the consent process.

(B) Expanding the ambit of Conflicted Transactions

The AIF Regulations currently rely on the definition of 'associate' to determine the scope of conflict-related safeguards. Based on supervisory experience, SEBI has observed that the existing definition does not adequately capture certain relationships and transactions that may give rise to genuine conflict-of-interest concerns. The Consultation Paper signals SEBI's intent to prevent materially conflicted transactions from escaping investor oversight merely because they fall outside the existing definitional threshold.

1. *Limitations of the "associate" definition*

   Under the current framework, an 'associate' is defined in a limited manner to cover entities in which a director, trustee, partner, sponsor or manager of the AIF (or a director/partner of the manager/sponsor) holds more than 15% of equity share capital or partnership interest, individually or collectively. This definition underpins key safeguards, including: (i) the requirement to obtain 75% investor approval for investments in, or transactions with, associates (Regulation 15(1)(e) and (ea)); (ii) the prohibition on Special Situation Funds and Angel Funds investing in associates (Regulations 19F(4) and 19M); and (iii) disclosure requirements relating to fees charged by associates (Regulation 22(b)).

   SEBI has highlighted several situations that fall outside the current definition despite presenting potential conflict concerns. These include investments in companies that share a common director with the AIF manager; companies controlled by relatives of key personnel where the individual's shareholding is below the 15% threshold; companies whose controlling shareholder also controls the manager or sponsor; and transactions involving relatives of the manager, sponsor or their directors or partners. None of these arrangements currently trigger the investor approval requirements under the AIF Regulations.

2. *Introduction of "related party" standard*

   To address these gaps, SEBI has proposed introducing a "related party" definition in relation to the manager or sponsor, drawing from Section 2(76) of the Companies Act, 2013, with modifications to suit the AIF framework. Unlike the existing equity-threshold-based 'associate' test, the proposed 'related party' construct captures control-based relationships, relatives of key personnel and influence-based connections, reflecting a more substance-oriented approach to identifying potential conflicts of interest.

3. *Calibrated application*

   Notably, SEBI has not proposed replacing the 'associate' definition entirely, but rather, the Consultation Paper proposes: (i) for certain matters that warrant a higher standard of governance and approval from investors (such as investment by the AIF in associates), the broader 'related party' standard would also apply additionally, and (ii) for certain other matters that are less material in nature (such as disclosure of disciplinary history under the PPM), the existing 'associate' definition would continue. This calibrated approach targets the specific regulatory gap without unintentionally widening obligations in unintended contexts.

4. *Exclusion for trustees and AIF boards*

   Noting the limited role of trustees in an AIF, SEBI has proposed excluding related parties of the trustee (for trust structures), as well as the board of directors or designated partners of the AIF (for AIFs structured as companies or limited liability partnerships), from the scope of the expanded conflict framework.

5. *Analysis*

The proposed shift to a 'related party' standard would capture some of the relevant conflicted transactions that currently escape scrutiny under the current framework, including: (a) investments in companies with common directorships with the AIF manager or sponsor; (b) investments in companies controlled by relatives of the manager's or sponsor's directors or partners, even where their individual shareholdings fall below the existing 15% threshold; (c) investments in companies whose major shareholders also control the manager or sponsor; and (d) purchase or sale transactions involving relatives of the manager or sponsor or their directors or partners. The broader scope reflects SEBI's supervisory observations that the narrow equity-threshold-based test, by itself, may not adequately identify transactions involving material conflicts of interest.

Notably, the proposed 'related party' definition draws from Section 2(76) of the Companies Act, 2013, encompassing control-based relationships, relatives of key personnel (including members of a Hindu Undivided Family, spouses, parents, children, siblings and in-laws), as well as influence-based relationships where directors or managers act on the advice, directions or instructions of a related person.

(C) Key takeaways

The Consultation Paper marks another significant step in SEBI's continuing efforts to strengthen the governance framework for AIFs. By standardising investor consent mechanisms and broadening the scope of conflict-related safeguards, the proposed reforms reflect a clear shift towards a more substance-based approach to regulating conflicted transactions while promoting greater consistency, transparency, and investor protection.

While the fine print of the AIF Regulations pursuant to the Consultation Paper is expected to be prescribed through subsequent amendments and circulars, fund managers should proactively review their existing consent mechanisms, PPM disclosures and conflict-identification processes to assess their alignment with the proposed reforms. Early evaluation of existing fund documentation and governance processes will enable managers to respond efficiently should the proposals be implemented in their current form.

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