

Liability for Investment Committee Members of an AIF - Excessive or Necessary?

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Introduction

SEBI vide an amendment dated October 19, 2020¹ notified certain key amendments (“Amendment”) to be made to the SEBI (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”), including expanding the interpretation of the term ‘relevant professional qualification’ under Regulation 4(g) of the AIF Regulations. A key amendment made vide the notification, is with respect to the constitution of an investment committee (“ICOM”) by the manager of the Alternative Investment Fund (“AIF”) for approving investment decisions and the collective responsibilities of the manager and members of such ICOM.

The amended AIF regulations now provide for shared responsibilities for the members of the ICOM with the investment manager, which is a significant shift from the practice before such Amendment. We discuss below, the extent of liabilities that may now be imposed on the members of ICOM.

New Role and Responsibilities for ICOM Members

As opposed to the manager being solely responsible and accountable for the investment decisions to SEBI, regardless of the recommendations provided by the ICOM, the Amendments provide for the below in cases where an ICOM is set up for the AIF for approving investment decisions:

1. ICOMs will be equally responsible alongside the AIF managers for investment decisions of the AIF;
2. ICOM and AIF manager will be jointly and severally liable for compliance of the AIF investments with the AIF Regulations, governing documents of the AIF and other applicable laws;
3. External members of the ICOM not identified in the AIF documents at the time of on-boarding of investors will have to be added to the ICOM only upon receiving consent of at least 75% of investors by value; and

4. Compliance of any other conditions as may be specified by SEBI.

Responsibility of the ICOM Alongside the AIF Manager:

The liability and responsibilities of the members of the ICOM has significantly increased with the Amendment, consequently if the ICOM, constituted by the manager, plays a pivotal role in the investment decision making process for the AIF, then not only will the manager, but also the members of ICOM can be held liable for such decisions directly by the regulator, under the AIF Regulations. Considering that the liability for contravention of the AIF Regulations ties up with section 15EA the Securities and Exchange Board of India Act, 1992 ("SEBI Act"), ICOM members may be liable to penalty for breach of their newly introduced statutory obligations, for at least one lakh rupees extending up to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees or three times the amount of gains made out of such failure (if so determined), whichever is higher.

Prior to the Amendment, the members of ICOM, who had the decision-making powers only under the AIF documents, owed a fiduciary responsibility towards the AIF and its investors, whilst the primary responsibility of ensuring regulatory compliance was pinned onto the manager who would be liable for any contraventions of the AIF Regulations.

Compliance With the AIF Regulations:

The members of the ICOM shall be liable for compliance of the AIF investments, with the AIF Regulations, governing documents of the AIF and other applicable laws. This change in particular, is contrary to the global practices and standards, since the members of ICOM are not usually expected to be involved in the day-to-day activities of the fund and do not ordinarily keep a check on requisite compliances under various applicable laws. To keep a check on the legal and statutory compliances of the AIF, has ordinarily been the mandate of the AIF manager and the compliance officer.

As per Section 27² (i.e. contravention by companies) of the SEBI Act, every person who at the time the offence was committed was in charge of, and was responsible for the conduct of the business, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against except when such person is able to establish that he had no knowledge of the contravention or that he exercised due diligence to prevent such commission of offence.

Therefore, arguably, if a member of the ICOM is allegedly involved in a violation of the provisions of applicable law by the manager company, it will be on such member to establish that he did not consent or approve or did not have knowledge of the actions taken by the ICOM or the AIF manager, with respect to such violation. What comes as a good defence in such cases is a proper and comprehensive noting of the minutes of the ICOM meetings where each member's opinion/ reservation/ acceptance or rejection with reasons is recorded.

Conclusion

The Amendment seems to be an attempt by SEBI to (i) provide flexibility and comfort to the AIF managers in constituting their key investment teams and designing the decision - making process for the AIFs; and (ii) tighten its grip around the members of the ICOM, with respect to compliance of AIF investments with the applicable laws, most importantly the AIF Regulations. The Amendment is likely to ensure that the members of the ICOM, who are involved in the decision-making process of the AIF

are covered by appropriate insurances by the AIF manager.

As a reaction to the feedback received from the industry at large, SEBI while providing a statutory blessing to the concept of ICOMs, seems to have stretched a bit far, adding significant responsibilities on the members of the ICOM.

¹ <https://www.sebi.gov.in/legal/regulations/oct-2020/securities-and-exchange-board-of-india-alternative-investment-funds-amendment-regulations-2020-47914.html>

² Securities and Exchange Board of India Act, 1992- Section 27.(1) Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly: Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence

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