**SEBI allows LPs to choose the AIF investments they want to participate in**

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**Introduction**

In a circular issued last month (the “**Circular**”), the Securities and Exchange Board of India (the “**SEBI**”) has allowed specific investors to excuse or exclude themselves from any particular investment being made by an alternative investment funds (“**AIF**”) in which they have invested. Through the Circular, the SEBI has codified “excuse-exclude” norms often used by such AIFs such as private equity funds (“**PE Funds**”) or venture capital funds (“**VC Funds**”).

As per the Circular:

* An AIF may **excuse** its investors from participating in an investment opportunity, if:
* the investor confirms that its participation in the investment opportunity will violate any applicable law or regulation on the basis of advice received from a legal professional/ advisor; or
* the participation of the investor in such investment opportunity will be in contravention of the investor’s internal policy, which should have been duly disclosed to the AIF and should be a part of the contribution agreement or any other agreement signed with the AIF. (Any change to the terms of such agreement must be intimated to the AIF manager within 15 days.)
* An AIF may **exclude** its investors from participating in an investment opportunity, if the AIF manager is satisfied that the participation of any particular investor in the investment opportunity shall result in:
* the AIF scheme violating any applicable law or regulation; or
* any material adverse effect on the scheme of the AIF. In this regard, AIF managers will have to record the rationale behind such exclusion and keep on record the documents relied on in arriving at such a conclusion.
* The Circular also provides for partial excuse and exclusion if the investor in the AIF is also an AIF. In such a situation, the investor AIF may be partially excused or excluded to the extent of the contribution of its underlying investors who may be excused or excluded as permitted by the SEBI Circular. This must also be supported by a recording of the rationale along with the documents relied upon.

**Our comments**

Certain limited partners or investors in PE or VC Funds do not invest in, for instance, liquor-associated companies, gaming firms, or companies in a specific sector, as a matter of internal policy. By making the recording of reasons mandatory, the Circular introduces transparency and counters the practice of excluding certain limited partners or investors if there is a loss in certain investments. By crystallizing the excuse provisions, investors can no longer cherry-pick deals under the guise of excuse rights, as investors will now be required to make upfront disclosures of the industries in which they are prohibited from investing as a matter of internal policy.