THE ECONOMIC TIMES | Markets
English Edition ▾ | 15 July, 2022, 09:39 AM IST | Print Edition

Sebi now making surprise visits to private equity and hedge funds

Synopsis
The capital markets regulator has made surprise inspections at offices of at least 20 AIFs including domestic private equity and hedge funds in the last few weeks to examine whether these investment managers are fully compliant with the laws, said people with direct knowledge of the matter. Lawyers and market participants said such unexpected checks by regulatory officials at AIF offices are a recent phenomenon as Sebi has received complaints against these funds in the recent past.

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Mumbai: The Securities and Exchange Board of India (Sebi) has stepped up the vigil on fast-growing alternative investment funds (AIFs).

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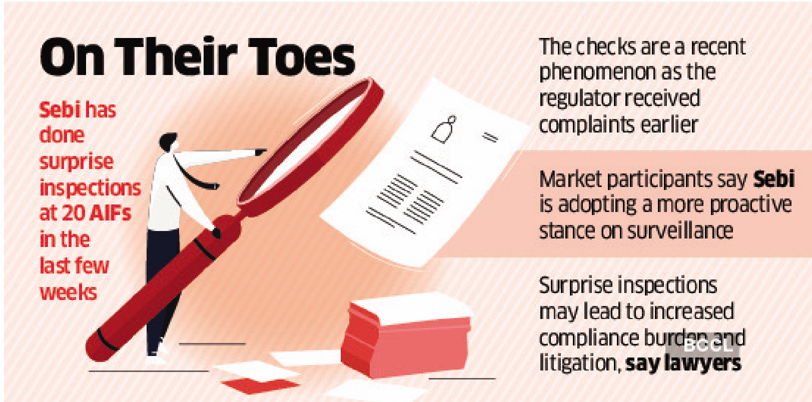
An email sent to Sebi seeking comments went unanswered.

During these inspections, Sebi is learnt to have checked if the funds have complied with various securities laws applicable. This includes adherence to portfolio concentration norms and timely disclosure to investors.

"Such surprise inspections are frequently being done by Sebi of late to examine due compliance and proper operations by these AIFs," said Nandini Pathak, leader, fund formation and regulatory practice at Nishith Desai Associates. "If the inspection exposes severe issues, then it could result in freezing of the AIF operations, premature liquidation and exits, no entry into capital markets, in each case for a specified period."

In the past, Sebi gave market institutions prior notice - usually a ten-day period - before the inspection. The regulator has now changed tack, exercising its powers to show up at the registered offices of market participants without giving any prior notice, said the people in the know.



Amid the stock market rally from March 2020 to October 2021, investment vehicles like mutual funds and AIFs have received a flood of money from investors. The total investments made by AIFs have risen 85% to ₹2.84 lakh crore in March 2022 from ₹1.53 lakh crore in March 2020, according to Sebi data. Investor requirements for differentiated services from mutual funds have resulted in AIFs mushrooming across the country.

Market participants and lawyers said Sebi is adopting a more proactive approach toward surveillance of AIFs. "These inspections would enable Sebi to create the desired deterrent effect and ensure AIFs take measures to relook at their internal monitoring mechanism for continual compliance," said Moin Ladha, partner, Khaitan & Co.

Some lawyers said the extensive use of the surprise inspection powers by Sebi may lead to an increased compliance burden and litigation for the funds. AIF regulations are supposed to be 'light touch regulations', which means limited regulatory interference unlike for mutual funds and brokerages as they largely cater to savvier investors, said lawyers.

"During inspections, Sebi found some violations by the AIFs, which are just technical in nature and do not have any major impact on the fund or its transparency," said a leading fund practice lawyer. "However, the regulator may now initiate proceedings against the fund since the observations made in the inspection report have to be given a logical conclusion."