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Revisiting AIF Exit Governance: A Critical Analysis of SEBI's Proposed Framework for Winding-Up and Registration Surrender

Pandurang Gireesh Balaganur[a]

[a]University School of Law, Bangalore, India

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Alternative Investment Funds (AIFs) have emerged as an important source of capital formation within India's financial ecosystem, facilitating investment into sectors such as infrastructure, private equity, venture capital and other areas that require long-term investment horizons. While the regulatory framework governing the establishment and operation of AIFs has undergone significant development since the introduction of the SEBI (Alternative Investment Funds) Regulations, 2012, the framework governing their closure and surrender of registration has remained comparatively underdeveloped. This regulatory gap has become increasingly evident as funds approaching the end of their tenure often continue to face unresolved obligations, including litigation, tax disputes and administrative liabilities, resulting in prolonged compliance burdens despite limited operational activity. This paper critically examines SEBI's proposed framework governing the winding up of AIFs and surrender of registration. It analyses the proposal's recognition of residual entities and its introduction of conditional flexibility permitting retention of funds beyond their prescribed tenure in limited circumstances. The paper argues that the proposal reflects a broader shift towards lifecycle-based regulation by distinguishing between actively operating funds and entities that continue solely for the purpose of resolving residual obligations. Such an approach has the potential to improve regulatory efficiency and better align supervision with the functional realities of fund closure. At the same time, the paper identifies several structural concerns within the proposed framework, including the absence of clearly defined retention thresholds, the possibility of prolonged residual entities, risks of regulatory arbitrage and practical challenges associated with investor coordination and regulatory oversight. Through a comparative examination of regulatory approaches adopted in the European Union, the United

Kingdom, Singapore, Mauritius and the United States, the paper highlights the importance of combining flexibility with robust disclosure obligations and supervisory safeguards. It concludes that SEBI's proposal represents a necessary and progressive reform.

Keywords: *fund winding up, lifecycle-based regulation, investor protection.*

INTRODUCTION

Alternative Investment Funds have become a critical component of India's financial ecosystem over the past decade;[1] they have helped in channeling capital into sectors such as infrastructure, private equity and other areas that require long-term and risk-tolerant investment. With the increased use of this investment instrument, the need for a nuanced regulatory framework governing not just their operation but also their exit has become increasingly apparent.

To fully appreciate the significance of the proposed reforms, it is important to briefly situate Alternate Investment Funds within the broader regulatory architecture of India. The regulatory framework for AIFs in India is primarily governed by the SEBI (Alternative Investment Funds) Regulations, 2012, which were introduced to consolidate and regulate privately pooled investment vehicles that were earlier operating in a fragmented regulatory environment.[2] These regulations categorise AIFs into three broad categories based on their investment strategies and systemic impact, thereby creating differentiated compliance obligations depending on risk exposure and policy sensitivity.

Over time, SEBI has introduced several amendments to strengthen governance norms, enhance disclosure requirements and improve investor protection mechanisms. However, while the entry and operational phases of AIFs have been subject to continuous regulatory refinement, the exit phase has remained in the nascent stage. This lack of regulatory attention has contributed to a structural imbalance in the lifecycle governance of AIFs, where commencement and operation are tightly regulated but closure remains ambiguous in practice.

[1] 'Data relating to activities of Alternative Investment Funds (AIFs)' (*SEBI*) <https://www.sebi.gov.in/statistics/1392982252002.html> accessed 12 June 2026

[2] SEBI (Alternative Investment Funds) Regulations 2012

This regulatory gap becomes particularly significant in the context of long-duration funds such as private equity and infrastructure AIFs, where investment periods extend over multiple years and asset liquidation is inherently uncertain.[3] In such cases, the absence of a clearly defined and practically enforceable winding-up framework creates uncertainty not only for fund managers but also for investors and regulators.

The AIF regulatory timelines in place have ensured smooth operation, with light being shed on different stages of the same; however, the closure of AIFs is not straightforward in practice. This is due to the reason that funds continue to face unresolved obligations even after the end of their tenure. These include ongoing litigations, tax disputes, or other administrative expenses, due to which funds need to tick all compliance requirements despite limited operational activity, which creates inefficiencies and delays. This is where the existing framework begins to show its limitations.[4]

Given all this, SEBI proposed a revised framework governing the winding up of AIFs and surrender of registration. The proposal introduces conditional flexibility by allowing retention of funds beyond the prescribed tenure in specific circumstances; it also goes a step ahead and acknowledges the existence of inactive or residual entities that continue solely to resolve outstanding obligations. While SEBI's move represents a pragmatic shift, it still renders the framework structurally incomplete. In specific, the absence of clearly defined limits on fund retention, standing out against the ever-high possibility of prolonged residual entities and the operational difficulty of investor coordination, brings about important questions which, if not answered, make the framework not achieve its intended objectives.

LIFECYCLE-BASED REGULATION AND THE EVOLUTION OF AIF EXIT GOVERNANCE

The regulatory framework governing Alternative Investment Funds has applied compliance obligations uniformly across all stages of a fund's lifecycle. This approach assumes that a fund nearing closure continues to pose the same level of regulatory concern as a fund actively

[3] Arpan Sheth et al., 'India Private Equity Report 2025' (*Bain & Company*, 06 May 2025) <https://www.bain.com/insights/india-private-equity-report-2025/> accessed 12 June 2026

[4] SEBI, *Consultation Paper on Flexibility to Alternative Investment Funds in Winding Up of Schemes and Surrender of Registration* (2026)

engaged in investment activity; in practice, this assumption often proves to be unrealistic.[5] Funds that have ceased active operations may remain subject to extensive compliance requirements merely because certain obligations continue to exist,

The rigidity of the earlier model produces several operational inefficiencies in the form of pending tax disputes that funds may face even after the completion of the investment period, which may eventually trickle down to unresolved litigation. An additional dimension that requires consideration in this context is the fiduciary obligation of fund managers during the wind-down phase. Even after active investment activity ceases, fund managers continue to owe duties of care, loyalty, and good faith towards investors. These obligations do not automatically diminish upon expiry of the investment period, particularly where residual assets, contingent liabilities, or ongoing disputes remain unresolved.[6]

However, the continuation of fiduciary duties in a structurally inactive fund creates a legal and operational paradox. On one hand, fund managers are required to act in the best interest of investors and ensure orderly liquidation, and on the other hand, the regulatory framework may impose compliance requirements that are disproportionate to the actual level of activity within the fund. This tension often results in a compliance- heavy environment where legal obligations persist even when commercial decision-making activity has significantly reduced.

As a result, managers are often compelled to maintain the fund structure solely to address these residual concerns, which increases compliance costs without necessarily serving a meaningful regulatory purpose. The revised framework proposed by SEBI appears to reflect a shift towards lifecycle-based regulation under which the intensity of regulatory obligations is aligned with the actual functional stage of the entity, with a fund actively deploying capital being treated differently from a fund that merely exists to resolve residual liabilities.

This shift is prominent because it recognises the economic realities associated with fund closure; once active investment ceases, the risks posed by the fund change considerably. In such a scenario, imposing the same degree of compliance obligations may create unnecessary

[5] Nicolas P B Bollen & Jeffrey A Busse, 'Short-Term Persistence in Mutual Fund Performance' (2005) 18(2) The Review of Financial Studies <https://www.jstor.org/stable/3598046> accessed 12 June 2026
[6] John D Morley, 'The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation' (2014) 123 Yale Law Journal <https://yalelawjournal.org/article/the-separation-of-funds-and-managers-a-theory-of-investment-fund-structure-and-regulation> accessed 12 June 2026

burdens without corresponding regulatory benefit. A more calibrated framework may therefore improve efficiency. For instance, a fund involved in pending tax reassessment proceedings may continue to require a limited operational structure even after its investment activity has concluded; under the earlier rigid framework, such entities would still remain subject to extensive compliance obligations despite functioning only for the purpose of resolving residual liabilities. The revised framework attempts to address this practical concern by recognising the distinction between active and residual stages of operation.

At the same time, introducing flexibility into the exit framework also raises concerns regarding regulatory consistency; in the absence of clearly defined standards, different fund managers may adopt varying interpretations regarding the scope and duration of residual obligations. This may gradually produce inconsistent supervisory outcomes, particularly in situations involving prolonged litigation.

The proposal also reflects a broader trend in financial regulation toward proportionality and functional supervision. Modern regulatory systems increasingly recognise that entities at different stages of operation require different levels of scrutiny, and by doing so SEBI appears to be moving towards a more adaptable framework. However, the shift introduced by the framework may not be entirely complete; while flexibility has been introduced, the proposal does not clearly define the boundaries between operational and residual stages, which creates uncertainty regarding when a fund can genuinely be considered inactive in nature.

The absence of precise thresholds may result in inconsistent interpretation across different funds and managers; thus, while the proposed framework represents a significant conceptual improvement over the earlier rigid model, important structural concerns continue to remain. The true effectiveness of lifecycle-based regulation will depend on how clearly these distinctions are implemented and supervised in practice.

ASSESSING THE MERITS OF SEBI'S PROPOSED WINDING-UP FRAMEWORK

One of the most significant aspects of the proposed framework lies in its attempt to introduce greater flexibility into the process governing fund closure, with the earlier system often treating fund exits as a rigid and time-bound process despite the known fact that certain obligations frequently continue beyond the prescribed tenure. The proposal allowing retention of funds in limited circumstances addresses this practical concern, with complex scenarios like unresolved liabilities making immediate distribution commercially impractical.

By permitting retention under specific conditions, the framework recognises the operational realities associated with fund winding up; this flexibility may help in the prevention of premature liquidation of assets merely to comply with regulatory timelines. The practical relevance of this flexibility can be better understood through real-world fund scenarios; in some instances, premature dissolution of the fund structure would not only complicate legal representation but also risk undermining the enforceability of claims. Maintaining a limited operational structure becomes necessary solely for dispute resolution purposes.

Similarly, infrastructure-focused AIFs often face delays in asset monetisation due to regulatory approvals, tariff disputes or contractual renegotiations. These delays are not always within the control of the fund manager and may extend beyond the originally expected fund tenure; a rigid closure requirement in such cases would force distressed liquidation or value erosion.

These scenarios highlight why a degree of regulatory elasticity is necessary in the winding-up framework. However, they also demonstrate the need for clearly defined boundaries to ensure that such flexibility does not become a mechanism for indefinite extension of fund life. Delays in resolving residual obligations often prevent timely redeployment of capital into productive sectors of the economy; by facilitating a more orderly and practical closure mechanism, the proposal may support smoother capital circulation within the investment ecosystem. This is particularly relevant in situations where unresolved obligations continue for limited periods after the conclusion of active investment activity; a rigid liquidation requirement in such circumstances may produce commercially inefficient outcomes for both managers and investors.

The proposal also acknowledges the existence of inactive entities. This is an important development because the earlier framework did not bifurcate between active investment activity and post-operational obligations; this brings much-needed conceptual clarity into the regulatory structure.

The framework, at the same time, attempts to retain certain safeguards relating to investor protection with requirements involving disclosure and investor approval, ensuring that the flexibility granted to fund managers is not entirely unrestricted; this balance between flexibility and accountability strengthens the legitimacy of the proposal. However, the effectiveness of the same will ultimately depend on the clarity of the implementation standards and the consistency of regulatory supervision.

STRUCTURAL CONCERNS AND UNRESOLVED REGULATORY CHALLENGES

Despite the advantages being present in the revised framework, several structural concerns continue to remain insufficiently addressed; these are significant given that they directly affect the effectiveness of the exit process. One of the primary concerns relates to the absence of clearly defined limits on the retention of funds, which is accompanied by a lack of detailed guidance regarding duration and thresholds of such retention.[7]

This absence of such limits also creates the possibility of misuse; in practice, funds may continue to operate in a residual form for extended periods under the justification of unresolved obligations, which risks undermining the very objective of ensuring timely closure and regulatory certainty. Beyond operational inefficiencies, an important concern arising from the absence of clear exit thresholds is the potential emergence of regulatory arbitrage. In the absence of strict timelines or objective criteria defining when a fund must be compulsorily wound up, fund managers may retain residual structures for strategic purposes unrelated to genuine obligations. This could include maintaining entities to defer tax implications, delay distribution waterfalls, or retain advisory control over legacy investments.

Such practices may create a moral hazard where the incentive to formally conclude fund operations is weakened; instead of acting as a temporary mechanism for resolving residual obligations, the fund structure may evolve into a semi-permanent vehicle with limited regulatory scrutiny. This outcome would be contrary to the original intent of lifecycle-based regulation and could dilute investor confidence in the AIF ecosystem.

A related issue is the possibility of prolonged residual entities; the proposal acknowledges the existence of inactive funds but does not adequately clarify when such entities must

[7] *Institutional Investors and Long-Term Investment: Policy Considerations* (OECD Publishing, 2025)

ultimately cease to exist. Without a clearly defined endpoint, residual entities may continue indefinitely with limited operational activity.

The requirement of investor participation may also create practical complications; obtaining consensus among investors is not always easy, and in large funds differing commercial interests may significantly delay decision-making processes. This framework leaves several operational questions unanswered - this can be seen in the ambiguity surrounding how regulators will verify the legitimacy of retained obligations or determine whether continued retention is genuinely necessary. Hence, while the proposal attempts to introduce flexibility into the exit process, it creates new areas of uncertainty which will persist unless supported by clearer standards.

COMPARATIVE PERSPECTIVES ON FUND CLOSURE AND RESIDUAL ENTITY REGULATION

A comparative analysis of foreign regulatory approaches provides an insight into the strengths and limitations of India's proposed framework; several jurisdictions have already adopted more flexible approaches towards fund closure and residual operations. The European Union's mechanisms operate within a lifecycle-oriented regulatory structure, which means that funds undergoing closure remain subject to disclosure obligations but compliance requirements are often calibrated according to the nature of residual activity. An important feature of this approach lies in its emphasis on transparency and supervisory monitoring, wherein flexibility is not granted unconditionally; it is accompanied by detailed reporting requirements and continuing fiduciary obligations.

A similar approach may be observed in the United Kingdom, where regulatory expectations continue during the wind-down stage but are tailored to investor protection concerns. In addition to the jurisdictions already discussed, regulatory approaches in Singapore and Mauritius also reflect important insights. Singapore's regulatory framework, administered by the Monetary Authority of Singapore, adopts a principle-based approach where fund disclosure is primarily governed through disclosure obligations and fiduciary duties rather than rigid statutory timelines. However, this flexibility is balanced by strong supervisory oversight and clear expectations regarding investor communication during the wind-down phase.[8]

Similarly, Mauritius, which is a widely used jurisdiction for India-linked offshore funds, provides structured but flexible dissolution mechanisms that allow funds to continue solely for the purpose of settling liabilities.[9] Importantly, these jurisdictions emphasise regulatory reporting and transparency as substitutes for strict temporal restrictions. This ensures that flexibility does not translate into ambiguity.

Fund managers are expected to prioritise fair treatment of investors while ensuring orderly closure; in contrast, the United States relies more heavily on contractual governance and disclosure obligations rather than rigid statutory timelines - this model allows for greater commercial flexibility but also places significant reliance on private ordering and investor sophistication.[10]

An important similarity across these jurisdictions is the recognition that residual or inactive entities continue to require some degree of regulatory oversight even after active investment activity ceases to exist. However, such oversight is usually accompanied by clearer disclosure obligations and supervisory standards that help prevent prolonged operational uncertainty. Compared to these jurisdictions, India's framework appears to adopt a more formalised structure for recognising residual entities, which does improve clarity but still lacks detailed guidance regarding retention thresholds and supervisory standards. Thus, a comparison with other jurisdictions suggests that flexibility in fund closure can be effective only when accompanied by strong disclosure standards and brevity in the form of defined exit thresholds.

IMPLEMENTATION CHALLENGES AND SUPERVISORY CONSIDERATIONS

The effectiveness of the proposed framework will ultimately depend less on its conceptual design and more on the manner in which it is implemented. While the proposal introduces

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[8] 'Guidelines on Licensing and Conduct of Business for Fund Management Companies [SFA 04-G05]' (*Monetary Authority of Singapore*, 03 September 2025) <https://www.mas.gov.sg/regulation/guidelines/guideline-sfa-04-g05-on-licensing-registration-and-conduct-of-business-for-fund-managers> accessed 12 June 2026

[9] *Collective Investment Schemes and Closed-End Funds Regulations* (Financial Services Commission Mauritius, 2022)

[10] *Private Fund Adviser Rules* (US Securities and Exchange Commission, 2023)

greater flexibility, translating it into consistent regulatory practice may prove to be challenging. One major concern relates to regulatory monitoring, as determining whether retained funds genuinely correspond to unresolved obligations may not always be straightforward.

The framework may also increase the administrative burden on the regulators and fund managers, as even inactive entities may continue to require documentation and periodic reporting. This raises questions regarding whether the intended reduction in compliance burden will fully materialise in practice; this is further accompanied by investor coordination, which presents another significant challenge due to differing commercial priorities. The proposal further assumes consistent regulatory supervision across different cases whilst negating the possibility that varying interpretations regarding residual obligations may lead to inconsistent enforcement outcomes.[11] This may become particularly problematic in cases involving complex residual obligations where supervisory interpretation plays a significant role in determining whether continued retention remains justified.

This in turn reduces the predictability of the regulatory framework and allows room for the possibility of certain entities exploiting the flexibility that was introduced by the framework to prolong their existence unnecessarily. In the absence of strict supervisory standards, residual structures may gradually evolve into a form of regulatory arbitrage; thus, while the framework represents a positive conceptual shift, its operational success remains uncertain. Much will depend on the development of clear implementation standards and effective regulatory oversight mechanisms.[12]

CONCLUSION

The proposed framework governing the winding up of Alternative Investment Funds represents a significant development in India's evolving regulatory approach towards private pooled investment vehicles. As the AIF ecosystem has expanded in both scale and complexity over the last decade, the limitations of a rigid and tenure-focused exit framework have become increasingly apparent. While the existing regulatory structure has been

[11] *Financial Sector Supervision and Regulatory Capacity Building in Emerging Economies* (World Bank, 2023)
[12] *Capital Market Development and Regulatory Reform in Asia* (Asian Development Bank, 2024)

relatively effective in governing the entry, operation and supervision of funds, the closure stage has remained characterised by practical uncertainties arising from unresolved obligations, pending disputes and continuing compliance requirements. In this context, SEBI's proposal may be viewed as a deliberate attempt to align regulatory expectations with the commercial realities associated with fund closure.

A notable strength of the proposal lies in its recognition that the winding-up process is not always capable of being completed within predetermined timelines. Alternative Investment Funds frequently operate within sectors characterised by long investment horizons, complex contractual arrangements and regulatory uncertainty. Consequently, obligations such as litigation, tax reassessments, indemnity claims and administrative liabilities often survive beyond the formal investment period of the fund. The proposal acknowledges this reality by permitting limited retention of funds and recognising the existence of residual entities whose purpose is confined to resolving outstanding obligations. In doing so, it departs from a rigid conception of fund closure and instead adopts a more pragmatic understanding of how investment structures function in practice.

The framework is also significant because it reflects a broader movement towards lifecycle-based regulation. Rather than treating all funds identically irrespective of their stage of operation, the proposal implicitly recognises that the regulatory concerns associated with an actively investing fund differ from those associated with a fund that has effectively ceased investment activity and exists solely to discharge residual obligations. This shift towards proportionality and functional supervision has the potential to reduce unnecessary compliance burdens, improve operational efficiency and facilitate a more orderly exit process. From a regulatory perspective, such an approach is capable of producing outcomes that are both commercially sensible and administratively efficient.

At the same time, the proposal raises a number of concerns that warrant careful consideration. The most significant of these relates to the absence of clearly defined parameters governing the retention of funds and the continued existence of residual entities. While flexibility is undoubtedly necessary, flexibility without clearly identifiable boundaries may create uncertainty regarding the duration and legitimacy of continued fund operations. In the absence of objective criteria, different fund managers may adopt varying interpretations regarding what constitutes a residual obligation and how long such obligations justify the continuation of the fund structure. This risks producing inconsistent supervisory outcomes and reducing regulatory predictability.

The possibility of regulatory arbitrage further complicates the picture. Residual structures are intended to serve as temporary mechanisms for resolving outstanding liabilities. However, where clear exit thresholds are absent, there remains a risk that such structures may be retained for reasons unrelated to genuine unresolved obligations. Over time, this may weaken incentives for efficient closure and potentially undermine investor confidence in the integrity of the regulatory framework. Similar concerns arise in relation to investor participation, as obtaining consensus among a diverse group of investors may not always be straightforward. Practical difficulties associated with coordination and decision-making may inadvertently prolong closure processes and create additional administrative burdens.

Comparative experiences from jurisdictions such as the European Union, the United Kingdom, Singapore, Mauritius and the United States demonstrate that flexibility in fund closure can be effectively implemented, but only when accompanied by strong disclosure standards and clear supervisory expectations. Although the institutional structures adopted by these jurisdictions differ considerably, a common theme emerges in the form of continued regulatory oversight, transparency and accountability during the wind-down phase. The comparative analysis therefore suggests that flexibility should not be viewed as an alternative to regulation but rather as a regulatory tool that must operate within clearly defined limits.

Ultimately, the success of the proposed framework will depend less upon its conceptual foundations and more upon the manner in which it is implemented. A framework that permits retention without adequate safeguards risks creating uncertainty, while a framework that prioritises rigid closure may fail to accommodate genuine commercial realities. The challenge before SEBI is therefore one of balance. The regulatory objective should not be to maximise flexibility or finality in isolation, but rather to develop a system capable of achieving both simultaneously. This may require the introduction of objective criteria governing residual status, enhanced disclosure obligations, periodic supervisory review and clearly identifiable exit thresholds designed to prevent indefinite continuation.

Viewed in its entirety, the proposal represents a positive and necessary evolution in the regulation of Alternative Investment Funds in India. It acknowledges practical realities that were insufficiently addressed under the earlier framework and attempts to create a more adaptable mechanism for fund closure. Nevertheless, important structural questions remain unresolved and will require further clarification if the framework is to achieve its intended objectives. If accompanied by clear implementation standards and robust supervisory safeguards, the proposed reforms possess the potential to strengthen both the efficiency and credibility of India's AIF regulatory ecosystem. In doing so, they may contribute towards a more mature, predictable and commercially responsive framework capable of supporting the continued growth of alternative investments within the Indian financial system.[13]

[13] SEBI, *Annual Report 2024–25* (2025)