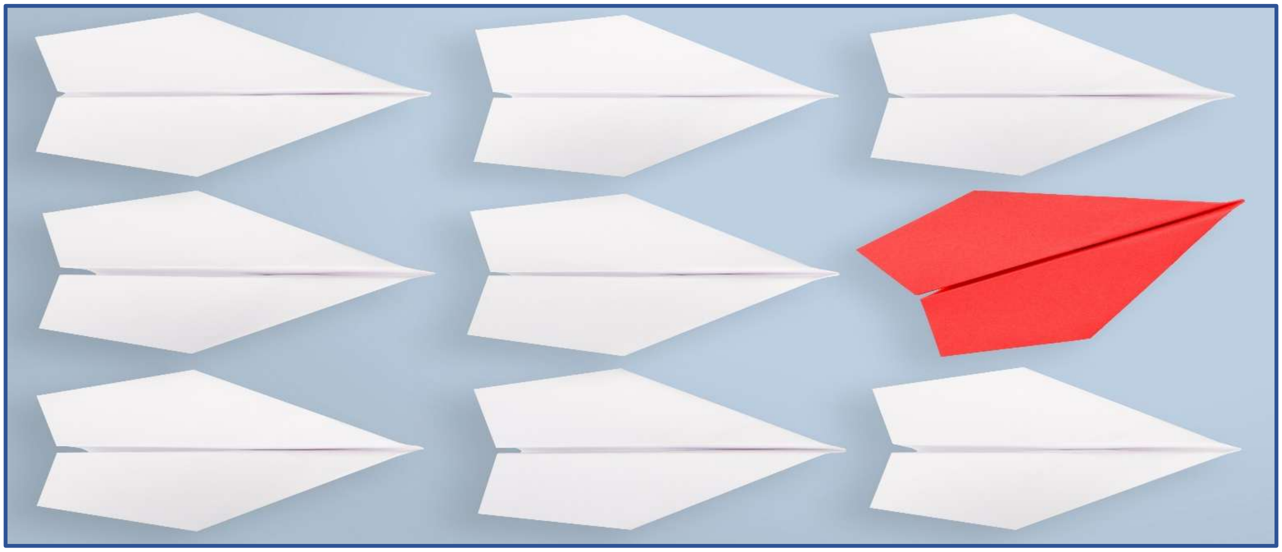
NEWS ALERT

10 July 2026



SEBI introduces 'Inoperative Fund' status guidelines for winding up and surrender of registration of AIFs/VCFs with respect to retention of proceeds

Alternative Investment Funds ('AIFs') are required to liquidate their investments and distribute the proceeds to investors upon expiry of their permissible fund life. The Securities and Exchange Board of India ('SEBI') through a Circular[1] has introduced a framework to address practical challenges faced by AIFs in completing the winding-up process where liquidation proceeds are required to be retained towards pending liabilities or winding-up related operational expenses.

On 16 June 2026, SEBI issued a circular prescribing guidelines for retention of liquidation proceeds beyond the permissible fund life and introducing the concept of an Inoperative Fund for eligible AIFs and Venture Capital Funds ('VCFs') registered under the erstwhile SEBI (Venture Capital Funds) Regulations, 1996.

The circular permits AIFs and VCFs to retain liquidation proceeds beyond the permissible fund life in the following circumstances:

- Where the AIF/VCF has received a litigation notice, tax demand or communication from any regulatory, judicial or law enforcement authority indicating an existing or potential liability;

- Where the proceeds are required to be retained towards anticipated liabilities, subject to approval of at least 75% of the investors by value of their investment. In such cases, the investment manager is required to disclose the amount proposed to

[1] HO/19/34/11(2)2026-AFD-POD1/I/13764/2026

be retained and the estimated period of retention while seeking investor approval;

- Where the proceeds are required to be retained towards residual operational expenses in connection with the winding-up process. Such retention is permitted by substantiating through supporting documents for a period not exceeding three years from the expiry of the permissible fund life.

The Circular further provides that retained monies shall be invested only in the manner specified under the AIF Regulations until their distribution to investors. Once all pending liabilities have been discharged, the retained proceeds are required to be distributed to investors and the winding-up process shall be completed. Such monies shall be invested in accordance with Regulation 15(1)(f) of the AIF Regulations;

Eligible AIFs and VCFs, having one or more schemes, intending to surrender their registration but having retained proceeds or pending contingent matters may apply to SEBI for grant of such status. An Inoperative Fund shall not undertake any new investment activity, launch new schemes or charge management fees, except as permitted under the applicable fund documents. Inoperative Fund shall apply to SEBI for surrender of certificate of registration only after the liabilities are satisfied and the pending retained monies are distributed to the investors in all its schemes.

SEBI has also rationalised the compliance requirements applicable to Inoperative Funds by providing exemptions from certain periodic compliances. However, such funds are required to submit an annual report to SEBI within 30 days from the end of March of every financial year on the status of retained proceeds and pending liabilities until completion of the winding-up process and surrender of registration.

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Should you wish to discuss any of the above issues in detail or understand the applicability to your specific situation, please feel free to reach out to us on coe@jmpadvisors.in.

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