

SEBI proposes to replace “associate” with “related party” for identifying conflicted transactions in the AIF Regulations

A consultation paper issued on June 30, 2026, by SEBI (**Consultation Paper**) proposes to amend the SEBI (Alternative Investment Funds) Regulations, 2012 (**AIF Regulations**) to (i) rationalize the manner and threshold for obtaining investor consent, and (ii) replace the current narrow “associate”-based test with a broader “related party” framework (based on the definition in Section 2(76) of the Companies Act, 2013) for transactions involving material conflicts of interest. Public comments have been invited until July 21, 2026. Our previous Update dealt with SEBI’s proposals relating to investor consent. This Update addresses the second topic, namely the proposal to replace “associate” with “related party” for the purpose of identifying conflicted transactions which require investor consent.

THE EXISTING “ASSOCIATE” BASED FRAMEWORK

The term “associate” is defined in the AIF Regulations by reference to a shareholding test. A company, limited liability partnership or body corporate is an “associate” if more than 15% of its paid-up equity share capital or partnership interest is held, either individually or collectively, by any of the following persons:

- a director, trustee or partner of the AIF; or
- the Sponsor or the Manager of the AIF; or
- a director or partner of the Manager or the Sponsor.

The term “associate” is used across the AIF Regulations to prescribe safeguards for activities and transactions that carry an inherent conflict of interest. The key provisions in this context are the following:

- Regulation 15(1)(e) and Regulation 15(1)(ea): an AIF may invest in its associates, or buy or sell investments from or to its associates, only with the prior approval of 75% of investors by value of their investment in the AIF or scheme;
- Regulation 19F(4) and Regulation 19M: Angel Funds and Special Situation Funds are prohibited altogether from investing in associates; and
- Regulation 22(b): any fees charged to the AIF or any investee company by an associate of the Manager or Sponsor must be disclosed periodically to the investors.

RATIONALE FOR REPLACEMENT OF “ASSOCIATE” WITH “RELATED PARTY” IN THE AIF REGULATIONS

SEBI has observed in the Consultation Paper that the current definition of “associate” is narrow and leaves out several transactions which are inherently conflicted and would require investor consent. The Consultation Paper gives the following examples of transactions which do not trigger the investor consent requirement under the extant framework:

- investment by an AIF in an investee company whose director is also a director of the AIF’s manager or sponsor;
- investment by an AIF in an investee company in which the controlling stake is held by the immediate relatives of a director or partner of the AIF’s manager or sponsor, though the director alone holds less than 15%;
- investment by an AIF in an investee company whose major shareholder also owns a majority stake in the manager or sponsor of the AIF; and
- an AIF buying or selling its investments from or to a person who is a relative of the manager or sponsor or their directors or partners.

Therefore, Consultation Paper proposes to replace the term “associate” with the term “related party” in a number of provisions dealing with conflict of interest or conflicted transactions, though in a few instances, the existing reference to “associate” is to be retained where such broader coverage is not warranted. The proposed definition of ‘related party’, which is borrowed from Section 2(76) of the Companies Act, 2013, identifies related parties through a list of relationships and is given in Annexure D of the Consultation Paper.

The related party definition results in expanding the scope of conflicted transactions significantly. For instance, a company or LLP becomes an associate of another company or LLP only where the parties concerned collectively hold more than 15% of its equity share capital or partnership interest. However, under the proposed related party definition if a director of the Investment Manager is merely a member or director of a private company, that company would qualify as a “related party” even though neither the Investment Manager nor the director holds more than 15% of its share capital. Consequently, an investment by the AIF into such private company would require prior investor approval under Regulation 15(1)(e).

Some of the provisions of the AIF Regulations and circulars where the Consultation Paper proposes to retain the reference to ‘associate’ are:

- Regulation 11(2) of the AIF Regulations which requires that an AIF shall include history of disciplinary actions in its PPM. In this regard, AIFs are required to include in their PPM, disciplinary history of inter alia the AIF, sponsor, manager and their directors/partners/promoters and associates
- Regulation 20(11A) of the AIF Regulations, which prescribes the conditions subject to which a custodian that is an associate of the sponsor or manager may act as custodian of the AIF;
- Paragraph 2.4.4 of SEBI Master Circular for AIFs which requires that the merchant banker appointed for filing the placement memorandum not be an associate of the AIF, its sponsor, manager or trustee; and
- Paragraph 18.3.1 of the SEBI Master Circular for AIFs which requires that the independent valuer not be an associate of the manager, sponsor or trustee of the AIF.

Annexure B of the Consultation Paper has a comprehensive list of all provisions of the AIF Regulations and related regulations which contain a reference to ‘associate’ and detail whether such provision will undergo any change.

ELP Comments

- *The proposed shift from ‘associate’ to ‘related party’ will align the AIF Regulations with other SEBI regulations such as SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, the SEBI (Portfolio Managers) Regulations, 2020, the REIT and InvIT Regulations. Annexure C of the Consultation Paper has extracts of various such regulations in which conflicted transactions are screened and regulated using the yardstick of “related party”.*
- *While the existing definition of ‘associate’ extends to entities connected with the director, trustee or partner of the AIF, the proposed definition of ‘related party’ is confined to the manager and sponsor of the AIF. SEBI has consciously excluded transactions involving related parties of the trustee of the AIF or director and partner of the AIF (in case AIF is set up as a company or LLP) from the ambit of conflicted transactions requiring investor approval. According to the Consultation Paper, this exclusion is based on the limited role performed by these entities in the day-to-day management and investment decisions of the fund. The proposal therefore seeks to align the scope of the conflict management framework with those entities who are capable of influencing investment decisions.*
- *Currently, the AIF Regulations do define ‘related party’, though this definition is not in the Definitions section (Regulation 2), but is in Regulation 19A(3), which is in Chapter 3A, and applies only to Angel Funds. This definition is based on the definition of ‘related party’ given in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and is used only in the context of angel funds. The Consultation Paper is silent on this existing definition, and it is unclear if it will be retained or not.*
- *Currently, the AIF Regulations follow a dual regime for conflicted transactions involving “associates”. Certain transactions involving associates are entirely prohibited, such as the transaction described in Regulation 20(11A)¹ of the AIF Regulations and cannot be overridden with investor consent. Many other types of conflicted transactions involving associates do not face an outright prohibition and may proceed, if approved by investors. Once the proposal in the Consultation Paper for shifting from ‘associate’ to ‘related party’ is implemented, the same dual approach will continue. Most of the conflicted transactions involving related parties can be approved*

¹ Regulation 20(11A) of the AIF Regulations states that in certain specific circumstances an entity that is an associate of the sponsor or manager may not act as custodian of the AIF

by investors. A few, such as the absolute prohibition in Regulation 19F(4) of AIF Regulations, which says “Angel funds shall not invest in associates”, will continue to subsist, albeit with “associates” replaced with ‘related parties’.

The consultation paper dated June 30, 2026 can be found [here](#).

We hope you have found this information useful. For any queries/clarifications please write to us at insights@elp-in.com or write to our authors:

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