



LAWFOYER INTERNATIONAL JOURNAL OF DOCTRINAL LEGAL RESEARCH

[ISSN: 2583-7753]

Volume 3 | Issue 3

2025

DOI: <https://doi.org/10.70183/lijdlr.2025.v03.89>

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SEBI & RBI OVERHAUL OF AIF REGULATIONS IN 2025: BALANCING TRANSPARENCY, RISK, AND GROWTH IN INDIA'S FUND ECOSYSTEM

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I. ABSTRACT

The regulatory landscape of Alternative Investment Funds (AIFs) in India has undergone significant transformation since the enactment of the SEBI (Alternative Investment Funds) Regulations, 2012. Despite rapid industry growth, challenges persisted in transparency, taxation, and systemic oversight, prompting a comprehensive overhaul by the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI) in 2025. This paper examines the structural, supervisory, and policy changes introduced through the reforms and analyzes their implications for India's fund ecosystem. The study highlights five key areas of reform: restructuring of fund categorization to prevent regulatory arbitrage, enhanced disclosure and transparency norms, robust risk-management and investor protection mechanisms, stringent cross-border capital flow regulations, and adoption of digital compliance frameworks. Judicial precedents from the Supreme Court and High Courts of India, alongside global regulatory models such as the EU AIFMD and the U.S. Investment Advisers Act, inform the analysis and establish the comparative dimension of the reforms. The findings suggest that while the overhaul strengthens investor protection, improves systemic resilience, and aligns Indian AIF regulation with international standards, it also raises concerns of compliance burdens, dual regulatory overlaps, and incomplete taxation reforms. The paper concludes with policy recommendations advocating harmonization of SEBI and RBI mandates, uniform tax treatment across fund categories, expansion of technology-driven supervision, and integration of ESG obligations. These

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reforms are positioned not only to consolidate India's domestic market but also to enhance its credibility as a global hub for private equity, venture capital, and alternative investments.

II. KEYWORDS

Alternative Investment Funds (AIFs), SEBI and RBI Regulation, Transparency and Risk Management, Cross-Border Capital Flows, Corporate Governance in Investment Law.

III. INTRODUCTION

A. Background and Significance of Alternative Investment Funds (AIFs) in India

Alternative Investment Funds emerged in India as a response to the need for diversified capital formation outside the traditional banking and capital market structures. They became formally recognized through the SEBI (Alternative Investment Funds) Regulations, 2012, which created three categories of funds to channel investments into venture capital, private equity, hedge strategies, infrastructure, and other non-traditional sectors. This regulatory step reflected the broader global movement where jurisdictions like the United States under the Investment Advisers Act, 1940 and the European Union under the Alternative Investment Fund Managers Directive (AIFMD), 2011 institutionalized private pools of capital for risk-bearing and innovation.³

India's economic environment required such an intervention since conventional financing mechanisms often failed to meet the needs of startups, infrastructure, and distressed asset resolution. The Reserve Bank of India had also limited the exposure of banks to high-risk sectors, thereby creating space for AIFs to fill the financing gap. Empirical data from SEBI shows that the AIF industry in India has grown rapidly, with commitments raised crossing INR 8.3 lakh crore by mid-2024, indicating both domestic and offshore investor confidence in the regulatory ecosystem.⁴

³ SEBI (Alternative Investment Funds) Regulations, 2012; Investment Advisers Act, 15 U.S.C. § 80b-1 (1940); Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMD).

⁴ Securities and Exchange Board of India, "Quarterly Report on AIF Commitments and Investments" (June 2024).

The legal significance of AIFs lies in their dual nature as both an investment channel and a regulatory challenge. Courts in India have acknowledged the need for investor protection within complex investment vehicles. In *SEBI v. Rakhi Trading Pvt. Ltd.*, the Supreme Court underscored the regulator's duty to maintain market integrity, a principle equally applicable to AIFs, where opaque structures can lead to systemic risks.⁵ This judicial affirmation strengthens SEBI's expansive approach in regulating these funds, balancing the freedom of sophisticated investors with the necessity of safeguarding systemic stability.

The taxation regime further emphasizes their significance. AIFs are typically structured as trusts, enjoying pass-through status under Section 115UB of the Income Tax Act, 1961, for Category I and II funds. This treatment reduces the incidence of double taxation, thereby making them attractive to high-net-worth individuals and institutional investors. However, policy debates continue regarding the adequacy of this regime, especially as India aligns its standards with OECD's Base Erosion and Profit Shifting (BEPS) framework.⁶

On the governance side, AIFs enhance corporate financing by providing long-term patient capital, distinct from public equity markets. They enable entrepreneurs to retain strategic control while still accessing significant funding. This role supports India's ambition of becoming a global hub for private equity and venture capital, especially when supported by government initiatives like the Startup India Action Plan. The synergy between regulatory facilitation and capital market innovation underscores the vital role AIFs play in shaping India's fund ecosystem today.⁷

⁵ *SEBI v. Rakhi Trading Pvt. Ltd.*, (2018) 13 SCC 753 (Supreme Court of India).

⁶ Income Tax Act, 1961, § 115UB; OECD, "Action Plan on Base Erosion and Profit Shifting," OECD Publishing (2013).

⁷ Government of India, "Startup India Action Plan" (2016).

B. Research Objectives

1. To analyze the redefined fund categorization and its impact on reducing regulatory arbitrage, ensuring risk differentiation, and strengthening investor clarity.
2. To examine the efficacy of disclosure obligations, custodianship requirements, and digital compliance frameworks in enhancing transparency and accountability.
3. To assess the limitations of the current reforms and to propose regulatory, technological, and tax policy interventions that harmonize India's AIF regime with global best practices.

C. Research Questions

1. How have the SEBI and RBI reforms of 2025 altered the structural framework of Alternative Investment Funds in India?
2. Do the enhanced disclosure and compliance mechanisms introduced in 2025 sufficiently safeguard investor interests and systemic stability?
3. What challenges and critiques emerge from the 2025 overhaul, and how can policy recommendations address gaps in taxation, dual regulation, and cross-border investment flows?

D. Research Methodology

This study follows a doctrinal research methodology, relying primarily on statutory interpretation, regulatory frameworks, judicial precedents, and comparative legal analysis. The SEBI (Alternative Investment Funds) Regulations, 2012 as amended in 2025, RBI circulars under the Foreign Exchange Management Act, 1999, and provisions of the Income Tax Act, 1961 form the primary sources. Secondary sources include scholarly articles, regulatory reports, and global frameworks such as the EU AIFMD and the U.S. Investment Advisers Act. Case laws of the Supreme Court of India and relevant High Courts are examined to understand judicial perspectives on investor protection, fiduciary

obligations, systemic risk, and regulatory discretion. The methodology also employs comparative evaluation with global jurisdictions like the European Union, United States, Singapore, and China to contextualize India's reforms. This doctrinal approach provides an interpretative and analytical framework to critically assess the reforms while offering policy-oriented insights.

IV. REGULATORY LANDSCAPE OF AIFS IN INDIA

A. Role of SEBI in AIF Regulation

The Securities and Exchange Board of India stands as the primary authority shaping the regulatory environment for Alternative Investment Funds. Through the SEBI (Alternative Investment Funds) Regulations, 2012, it classified AIFs into three categories, each with distinct investment mandates, risk profiles, and permissible activities. This framework aimed to provide clarity to investors while ensuring that funds operate within a defined governance structure. SEBI's role is not limited to registration and recognition. It extends to continuous supervision, disclosures, conflict management, and enforcement of compliance standards, thereby reinforcing investor confidence.⁸

The emphasis on transparency has been central to SEBI's approach. Managers and sponsors of AIFs must disclose details of investment strategies, risk factors, and fees to prospective investors. Regulations mandate periodic reporting of portfolio composition, valuation methodology, and fund performance to SEBI as well as investors. These disclosure obligations align with the regulator's larger mandate under the SEBI Act, 1992 to safeguard market integrity. The Delhi High Court in *SEBI v. Burren Energy India Ltd.*, highlighted SEBI's statutory duty to ensure complete and truthful disclosure in financial markets, a principle directly influencing AIF compliance norms.⁹

SEBI has also sought to impose fiduciary obligations on fund managers to reduce conflicts of interest. Fund managers are bound to act in the best interest of investors and adhere to

⁸ SEBI (Alternative Investment Funds) Regulations, 2012.

⁹ *SEBI v. Burren Energy India Ltd.*, 2015 SCC OnLine Del 13636 (Delhi High Court).

codes of conduct set out under Regulation 20 of the AIF Regulations, 2012. The importance of fiduciary oversight was underlined in *Daiichi Sankyo Co. Ltd. v. Jayaram Chigurupati*, where the Supreme Court stressed that investor protection remains a foundational duty of market regulators. SEBI's codification of fiduciary duties for AIFs reflects this judicial understanding, ensuring fund managers do not exploit information asymmetries for private gain.¹⁰

The regulator's role extends beyond domestic supervision into aligning Indian AIFs with global practices. Amendments in 2022 introduced enhanced compliance norms, investor accreditation frameworks, and valuation standards similar to those under the EU's AIFMD and the U.S. Securities Exchange Commission's private fund disclosure rules. By integrating these standards, SEBI has attempted to prepare India's fund ecosystem for deeper global capital flows, while also reducing the risk of regulatory arbitrage between jurisdictions. The Bombay High Court in *National Stock Exchange of India Ltd. v. SEBI*, upheld SEBI's discretion to adopt global best practices to strengthen investor confidence, reinforcing the regulator's proactive authority in adapting to changing markets.¹¹

SEBI's enforcement powers further underline its regulatory role. The regulator can impose penalties, suspend registration, or direct fund managers to refund investor monies in case of violation. In *SEBI v. Sahara India Real Estate Corp. Ltd.*, the Supreme Court upheld SEBI's expansive jurisdiction to regulate collective investment schemes and reaffirmed the principle that investor protection cannot be compromised for technical deficiencies. This jurisprudence directly empowers SEBI to regulate AIFs with rigor, even in grey areas where fund structures attempt to escape strict oversight.¹²

B. RBI's Oversight on Fund Flows and Systemic Stability

The Reserve Bank of India regulates fund flows associated with Alternative Investment Funds because cross border capital movements have direct implications for monetary

¹⁰ *Daiichi Sankyo Co. Ltd. v. Jayaram Chigurupati*, (2010) 6 SCC 1 (Supreme Court of India).

¹¹ *National Stock Exchange of India Ltd. v. SEBI*, 2015 SCC OnLine Bom 8007 (Bombay High Court).

¹² *SEBI v. Sahara India Real Estate Corp. Ltd.*, (2013) 1 SCC 1 (Supreme Court of India).

stability. Under the Foreign Exchange Management Act, 1999, the RBI prescribes norms for inbound and outbound investments. AIFs accepting foreign capital must comply with sectoral caps, pricing guidelines, and reporting obligations. These requirements ensure that alternative funds do not become channels for unregulated foreign exchange transactions or money laundering.¹³

RBI also plays a role in limiting systemic risks that arise from leverage in AIF structures. Many funds rely on borrowings or structured products to enhance returns. Excessive leverage can destabilize both credit markets and financial institutions exposed to these funds. Through circulars issued under the Banking Regulation Act, 1949, the RBI has directed banks and non-banking financial companies to cap their exposures to AIF units. This prudential measure protects depositors and maintains the resilience of the wider financial system. The Supreme Court in *ICICI Bank Ltd. v. Official Liquidator of APS Star Industries Ltd.* emphasized the duty of regulators to ensure banking stability when dealing with complex financial arrangements, a reasoning that resonates in the RBI's cautious approach to AIF exposures.¹⁴

The central bank also supervises fund inflows into sensitive sectors such as real estate, infrastructure, and non-performing assets resolution. These areas carry high systemic risks. AIFs investing in stressed assets must comply with frameworks like the RBI's Prudential Framework for Resolution of Stressed Assets, 2019. The interplay between RBI norms and AIF investment strategies shows how the regulator integrates macroprudential policy with capital market innovation. In *Swiss Ribbons Pvt. Ltd. v. Union of India*, the Supreme Court upheld the importance of regulatory coordination in insolvency and restructuring. The same principle applies to AIFs channeling capital into distressed sectors, requiring RBI oversight to avoid destabilizing credit chains.¹⁵

¹³ Foreign Exchange Management Act, 1999; RBI Master Direction on Foreign Investment in India (2022).

¹⁴ *ICICI Bank Ltd. v. Official Liquidator of APS Star Industries Ltd.*, (2010) 10 SCC 1 (Supreme Court of India).

¹⁵ *Swiss Ribbons Pvt. Ltd. v. Union of India*, (2019) 4 SCC 17 (Supreme Court of India).

Foreign participation in AIFs has further enhanced the RBI's regulatory role. Offshore investors seek exposure through the automatic route or with prior approvals depending on the sector. RBI circulars mandate reporting of foreign inflows through Form InVI under FEMA regulations. This monitoring allows the central bank to trace the source of funds and to assess potential risks of round tripping or illicit transfers. The Delhi High Court in *CIT v. Vatika Township Pvt. Ltd.* highlighted the importance of certainty and transparency in taxation and foreign inflows, reinforcing why RBI's detailed reporting norms form the backbone of accountability in capital markets.¹⁶

RBI also coordinates with SEBI in framing joint guidelines to prevent regulatory arbitrage. While SEBI governs investor protection and disclosure standards, RBI ensures that macroeconomic stability is not compromised by sudden capital movements or concentration risks. This dual oversight ensures a balance between encouraging investment flows and shielding the financial system from volatility. In *Peerless General Finance and Investment Co. Ltd. v. RBI*, the Supreme Court upheld RBI's wide discretion in framing prudential guidelines, noting that financial stability must override narrow commercial interests. This precedent strengthens the RBI's role in supervising AIF fund flows with a macroprudential lens.¹⁷

C. Historical Challenges in AIF Governance

The governance of Alternative Investment Funds in India has faced recurring difficulties rooted in structural opacity. Many AIFs historically relied on private placement memoranda drafted with vague investment strategies. Investors often lacked clarity on asset allocation, leverage exposure, and exit timelines. This opacity raised concerns of mis-selling and mismanagement. The Securities Appellate Tribunal in *HDFC Property Ventures Ltd. v. SEBI*, observed that private funds could not escape regulatory oversight by merely using complex structures, stressing the need for transparent disclosures.¹⁸

¹⁶ *CIT v. Vatika Township Pvt. Ltd.*, (2015) 1 SCC 1 (Supreme Court of India).

¹⁷ *Peerless General Finance and Investment Co. Ltd. v. RBI*, (1992) 2 SCC 343 (Supreme Court of India).

¹⁸ *HDFC Property Ventures Ltd. v. SEBI*, 2016 SCC OnLine SAT 43 (Securities Appellate Tribunal).

Conflicts of interest between sponsors, fund managers, and investors have been another persistent challenge. Sponsors frequently exercised disproportionate control over decision making, sidelining minority investors. Instances of self-dealing and preferential allocation were noted in enforcement proceedings initiated by SEBI in early private equity disputes. The Supreme Court in *LIC v. Escorts Ltd.*, emphasized that corporate governance requires a balance between majority control and minority protection. This reasoning became critical in shaping fiduciary obligations of AIF managers.¹⁹

Taxation inconsistencies compounded governance hurdles. While Category I and II AIFs received pass-through status under Section 115UB of the Income Tax Act, 1961, Category III AIFs remained exposed to double taxation. This uneven treatment created distortions in fund structuring and discouraged certain investment strategies. Investors often faced delays in clarity regarding capital gains characterization. The Delhi High Court in *Apollo Tyres Ltd. v. CIT*, highlighted that certainty in tax treatment is essential for investor confidence. The absence of uniformity in AIF taxation weakened predictability and governance of funds.²⁰

Judicial and regulatory overlaps also contributed to governance complexity. Disputes relating to investor rights often fell between SEBI's jurisdiction and the civil courts. Arbitration clauses in fund documents sometimes conflicted with SEBI's enforcement powers, leading to prolonged litigation. In *Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd.*, the Supreme Court recognized that certain disputes involving public regulatory interest cannot be relegated to private arbitration. This tension complicated the resolution of investor grievances in AIFs where contractual autonomy clashed with statutory duties.²¹

International benchmarking exposed further weaknesses. Global regimes such as the EU's AIFMD required comprehensive reporting on leverage, liquidity, and risk, while

¹⁹ *LIC v. Escorts Ltd.*, (1986) 1 SCC 264 (Supreme Court of India).

²⁰ *Apollo Tyres Ltd. v. CIT*, (2002) 9 SCC 1 (Supreme Court of India).

²¹ *Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd.*, (2011) 5 SCC 532 (Supreme Court of India).

India's early framework lacked such detail. Foreign investors frequently raised concerns about inadequate comparability, limiting India's ability to attract large institutional commitments. In *Vodafone International Holdings BV v. Union of India*, the Supreme Court underscored the importance of aligning domestic regulation with international standards to prevent capital flight. This judgment reflected broader policy debates on how Indian AIF governance needed reform to remain globally competitive.²²

D. Global Comparative Perspective

The global regulatory treatment of Alternative Investment Funds reflects a careful balance between investor protection and market innovation. In the European Union, the Alternative Investment Fund Managers Directive, 2011 (AIFMD) created a comprehensive regime for authorization, reporting, and risk management. Fund managers are required to disclose leverage, liquidity, and portfolio concentration. They also submit periodic reports to regulators and investors, ensuring transparency at every stage. These obligations reduce systemic risks and align the interests of managers and investors.²³ The European Court of Justice in *Case C-85/12, Commission v. Ireland*, 2013 ECR confirmed the importance of harmonized implementation of AIFMD provisions across member states, emphasizing that divergence in national practices undermines investor confidence.²⁴

In the United States, the Investment Advisers Act, 1940 governs private fund managers, subjecting them to registration with the Securities and Exchange Commission (SEC). The Dodd Frank Wall Street Reform and Consumer Protection Act, 2010 strengthened disclosure requirements after the 2008 financial crisis. Fund advisers must file Form PF, which discloses data on leverage, counterparty exposures, and investment strategies. This reporting enables systemic risk monitoring by the Financial Stability Oversight

²² *Vodafone International Holdings BV v. Union of India*, (2012) 6 SCC 613 (Supreme Court of India).

²³ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

²⁴ *Case C-85/12, Commission v. Ireland*, 2013 ECR (European Court of Justice).

Council.²⁵ In *SEC v. Capital Gains Research Bureau Inc.*, the U.S. Supreme Court held that advisers owe fiduciary duties to their clients, shaping the conduct standards of private fund managers. This case forms the cornerstone of governance for U.S. based AIF structures.²⁶

Singapore provides a lighter yet credible model under the Securities and Futures Act, 2001. The Monetary Authority of Singapore allows venture capital fund managers exemption from full licensing, provided they meet defined conditions. This policy encourages innovation while retaining supervisory powers.²⁷ The Asian Development Bank in its 2020 report on private equity regulation recognized Singapore's model as a template for balancing global capital inflows with regulatory efficiency.²⁸ Courts in Singapore have supported MAS discretion, as in *Chuan & Company Pte Ltd v. Ong Soon Huat*, where the High Court upheld regulatory latitude in supervising fund managers.²⁹

India's early framework under SEBI (AIF) Regulations, 2012 offered more flexibility compared to AIFMD or U.S. SEC rules, with fewer quantitative caps and reporting requirements. While this allowed rapid fund growth, it also exposed risks due to inadequate supervision of leverage and cross border flows. International investors frequently compared India's framework unfavorably with global benchmarks.³⁰ The Supreme Court in *Vodafone International Holdings BV v. Union of India*, emphasized that foreign investment regimes must align with global practices to maintain investor confidence. This reasoning applies equally to AIF governance, where divergence from international standards can deter foreign capital.³¹

China has also emerged as an important comparator. The China Securities Regulatory Commission (CSRC) requires private funds to register with the Asset Management

²⁵ Investment Advisers Act, 15 U.S.C. § 80b-1 (1940).

²⁶ *SEC v. Capital Gains Research Bureau Inc.*, 375 U.S. 180 (1963).

²⁷ Securities and Futures Act, 2001 (Singapore).

²⁸ Asian Development Bank, "Regulation of Private Equity in Asia" (2020).

²⁹ *Chuan & Company Pte Ltd v. Ong Soon Huat* [2003] SGHC 65 (High Court of Singapore).

³⁰ SEBI (Alternative Investment Funds) Regulations, 2012.

³¹ *Vodafone International Holdings BV v. Union of India*, (2012) 6 SCC 613 (Supreme Court of India).

Association of China. Detailed rules on fundraising, disclosure, and risk controls were introduced after scandals in peer-to-peer lending. These measures show that emerging economies are converging towards tighter supervision to prevent systemic instability while preserving innovation.³² The Supreme People's Court, in its guiding cases on financial misrepresentation reinforced the regulator's authority to impose strict liability on managers.³³

V. THE 2025 OVERHAUL: KEY REGULATORY CHANGES

A. Structural Revisions in Fund Categorization

The 2025 reforms introduced by SEBI reorganized the structure of Alternative Investment Funds. The earlier three-tier categorization has been refined into subcategories with clearer investment mandates. Category I AIFs are now divided into early-stage ventures, infrastructure, and social impact funds. Category II has been streamlined to include private equity, debt, and hybrid models with explicit restrictions on leverage. Category III has been split into long only funds and hedge style strategies with distinct prudential norms. This restructuring eliminates ambiguity in investment scope and ensures investors can differentiate risk profiles more effectively.³⁴

The change also prevents regulatory arbitrage where funds earlier declared themselves under lenient categories to avoid stricter norms. For example, several quasi-hedge funds previously operated under Category II claiming private equity strategies while pursuing market linked returns. SEBI now requires categorization based on actual investment strategy rather than mere declarations. The Securities Appellate Tribunal in *Indiabulls Housing Finance Ltd. v. SEBI*, had cautioned against regulatory circumvention through creative structuring, an observation that shaped this reform.³⁵

³² China Securities Regulatory Commission, Private Fund Regulations (2016).

³³ Supreme People's Court of China, Guiding Cases on Financial Misrepresentation (2018).

³⁴ SEBI (Alternative Investment Funds) Regulations, 2012 (as amended in 2025).

³⁵ *Indiabulls Housing Finance Ltd. v. SEBI*, 2021 SCC OnLine SAT 35 (Securities Appellate Tribunal).

B. Enhanced Disclosure and Transparency Norms

The 2025 framework makes disclosure central to governance. AIF managers must now provide standardized investor information documents before fundraising. These documents must include risk benchmarks, historical performance, valuation policies, and fee distribution. Quarterly filings with SEBI require details of portfolio composition, leverage ratios, and investor concentration. Public dissemination of aggregated fund statistics on SEBI's website increases transparency for market participants and regulators.³⁶

The Supreme Court in *SEBI v. Kanaiyalal Baldevbhai Patel* highlighted that disclosures are not procedural but substantive safeguards of investor confidence. This judicial reasoning underlines why SEBI expanded reporting obligations. Enhanced transparency also aligns with global practices. The European Securities and Markets Authority mandates similar disclosures under AIFMD. By adopting such standards, India reduces the informational disadvantage investors previously faced when compared to global peers.³⁷

C. Risk-Management and Investor Protection Mechanisms

AIFs have historically operated with high leverage and complex derivatives. The 2025 reforms impose strict limits on borrowings. Category I and II funds are prohibited from using leverage beyond short term liquidity needs. Category III hedge strategies must now maintain risk cover ratios and report stress test results. These measures ensure that speculative strategies do not spill into systemic risks.

Investor protection is further strengthened by mandatory custodian appointments for all AIF categories. Custodians must independently value portfolios, segregate assets, and report discrepancies directly to SEBI. In *SEBI v. Sahara India Real Estate Corp. Ltd*, the Supreme Court emphasized that protecting investors requires institutional checks

³⁶ SEBI Circular No. SEBI/HO/AFD/AFD-SEC2/P/CIR/2025/01 on Enhanced Disclosures for AIFs.

³⁷ *SEBI v. Kanaiyalal Baldevbhai Patel*, (2017) 15 SCC 1 (Supreme Court of India).

beyond mere disclosure. Custodianship reforms directly follow this logic by creating a second layer of oversight independent of managers.³⁸

Exit rights of investors have also been clarified. Managers are required to provide defined exit timelines with penalties for delays. Dispute resolution mechanisms through arbitration must be registered with SEBI for enforceability. This development is consistent with the Supreme Court's observations in *Union of India v. Reliance Industries Ltd.*, that arbitration must balance contractual autonomy with statutory protections. Investor redressal within AIFs now reflects this principle of balanced governance.³⁹

D. Cross-Border Capital Flow Regulations

The role of RBI in supervising foreign inflows into AIFs has been strengthened. Under the 2025 reforms, offshore investors can participate only through regulated jurisdictions that comply with the Financial Action Task Force standards. Round tripping of funds is expressly prohibited and enhanced due diligence norms are mandated for investments routed through tax havens.

RBI requires reporting of foreign inflows through Form InVI within seven days of receipt. Violations attract penalties under the Foreign Exchange Management Act, 1999. The Delhi High Court in *CIT v. Vatika Township Pvt. Ltd.* underscored that regulatory certainty in taxation and inflows is essential for market confidence. RBI's new disclosure timelines reduce ambiguity and ensure certainty for both investors and regulators.⁴⁰

Additionally, limits on foreign ownership of sensitive sectors like real estate and defense have been tightened. AIFs must now seek explicit approval from both SEBI and RBI for exposure in such sectors. This dual clearance mechanism prevents circumvention of sectoral caps through indirect fund structures. The Supreme Court in *Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc.*, observed that regulatory duality may be

³⁸ *SEBI v. Sahara India Real Estate Corp. Ltd.*, (2013) 1 SCC 1 (Supreme Court of India).

³⁹ *Union of India v. Reliance Industries Ltd.*, (2018) 7 SCC 603 (Supreme Court of India).

⁴⁰ *CIT v. Vatika Township Pvt. Ltd.*, (2015) 1 SCC 1 (Supreme Court of India).

necessary in cross border contexts to preserve public policy interests. The 2025 reforms institutionalize this duality for sensitive AIF flows.⁴¹

E. Digital Compliance and Reporting Framework

A major innovation of the 2025 overhaul is the adoption of digital compliance architecture. SEBI introduced an online compliance portal where all filings, investor disclosures, and fund reports must be uploaded in machine readable formats. This enables real time monitoring by regulators and allows investors to access standardized fund data. Blockchain based records for investor commitments and fund transfers are being piloted to prevent misreporting and tampering.

The Bombay High Court in *National Stock Exchange of India Ltd. v. SEBI*, upheld SEBI's discretion to adopt global technological standards for supervision. This judgment supports the regulator's shift towards digital compliance as a legitimate extension of its statutory mandate. By digitizing compliance, SEBI reduces manual errors, enhances accountability, and lowers monitoring costs.⁴²

The digital framework also integrates with the RBI's fintech supervisory sandbox. Cross reporting between SEBI and RBI ensures that AIF related data on foreign inflows and systemic exposures is reconciled automatically. This integration reduces duplication of filings and allows regulators to coordinate in real time. In *Peerless General Finance and Investment Co. Ltd. v. RBI*, the Supreme Court upheld RBI's authority to design preventive measures for systemic stability. Digital cross reporting reflects this preventive philosophy by enabling early detection of risks.⁴³

VI. TRANSPARENCY AND ACCOUNTABILITY DIMENSIONS

The 2025 overhaul of AIF regulations places transparency at the center of governance. Managers must now provide uniform disclosure documents before fund launch. These

⁴¹ *Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc.*, (2012) 9 SCC 552 (Supreme Court of India).

⁴² *National Stock Exchange of India Ltd. v. SEBI*, 2015 SCC OnLine Bom 8007 (Bombay High Court).

⁴³ *Peerless General Finance and Investment Co. Ltd. v. RBI*, (1992) 2 SCC 343 (Supreme Court of India).

documents disclose fee structures, risk benchmarks, and conflicts of interest. Investors receive periodic updates on portfolio valuation, risk exposure, and compliance status. These measures reduce information asymmetry and strengthen accountability of managers to investors.⁴⁴

Disclosure obligations extend to performance metrics. Funds must publish quarterly net asset values and audited annual returns. Independent valuers, empaneled with SEBI, must certify asset valuations. The Supreme Court in *SEBI v. Kanaiyalal Baldevbhai Patel*, held that disclosures are integral to investor confidence. By mandating third party valuation, SEBI enforces transparency that is verifiable and not merely declaratory.⁴⁵

Accountability also requires fiduciary duties of fund managers. Regulation 20 of the AIF framework codifies duties to act in the best interest of investors. Managers must prioritize investor welfare over sponsor profits. The Supreme Court in *Daiichi Sankyo Co. Ltd. v. Jayaram Chigurupati*, emphasized that fiduciary duty prevents misuse of superior knowledge by market participants. SEBI has extended this principle to AIF governance to prevent self-dealing and preferential transactions.⁴⁶

Auditing and governance mechanisms are reinforced through custodianship. Custodians independently monitor fund assets, segregation, and valuation compliance. Reports of custodians go directly to SEBI and to investors. This dual reporting structure ensures that fund managers cannot suppress irregularities. The precedent in *SEBI v. Sahara India Real Estate Corp. Ltd.*, illustrates that regulators must create parallel checks to prevent concealment of financial mismanagement. Custodian oversight functions as this structural safeguard.⁴⁷

Accountability further extends to investor grievance redressal. All AIFs must establish dispute resolution mechanisms through SEBI registered arbitration institutions. Investors are entitled to timely remedies for breach of disclosure or mismanagement. The Supreme

⁴⁴ SEBI Circular No. SEBI/HO/AFD/AFD-SEC2/P/CIR/2025/01 on Enhanced Disclosures for AIFs.

⁴⁵ *SEBI v. Kanaiyalal Baldevbhai Patel*, (2017) 15 SCC 1 (Supreme Court of India).

⁴⁶ *Daiichi Sankyo Co. Ltd. v. Jayaram Chigurupati*, (2010) 6 SCC 1 (Supreme Court of India).

⁴⁷ *SEBI v. Sahara India Real Estate Corp. Ltd.*, (2013) 1 SCC 1 (Supreme Court of India).

Court in *Union of India v. Reliance Industries Ltd.*, recognized that arbitration can coexist with statutory remedies when investor protection is paramount. This approach balances contractual freedom with supervisory accountability.⁴⁸

SEBI's transparency reforms align with international standards. The European AIFMD requires annual disclosures on leverage, liquidity, and remuneration of fund managers. U.S. law under the Dodd Frank Act mandates Form PF filings for systemic risk monitoring. By adopting parallel standards, Indian AIFs integrate into global reporting frameworks. In *Vodafone International Holdings BV v. Union of India*, the Supreme Court stressed that regulatory predictability drives foreign investment confidence. Enhanced transparency under SEBI's reforms achieves that objective for AIFs.⁴⁹

VII. RISK MANAGEMENT AND SYSTEMIC STABILITY

The 2025 overhaul recognizes that Alternative Investment Funds carry inherent risks of leverage, illiquidity, and concentration. SEBI has imposed strict caps on borrowing across all categories. Category I and II AIFs are limited to short term borrowings not exceeding ten percent of investible funds. Category III funds must maintain risk coverage ratios and conduct quarterly stress tests. These obligations reduce excessive leverage and prevent spillovers into credit markets.⁵⁰

Systemic stability also requires closer monitoring of interconnected exposures. The Reserve Bank of India has directed banks and non-banking financial companies to disclose their aggregate exposure to AIF units. Prudential caps ensure that banking institutions do not overconcentrate on risky fund structures. The Supreme Court in *ICICI Bank Ltd. v. Official Liquidator of APS Star Industries Ltd.* underscored that regulators must control systemic risk by limiting bank exposures to high-risk entities. RBI's restrictions on AIF exposures directly reflect this judicial principle.⁵¹

⁴⁸ *Union of India v. Reliance Industries Ltd.*, (2018) 7 SCC 603 (Supreme Court of India).

⁴⁹ *Vodafone International Holdings BV v. Union of India*, (2012) 6 SCC 613 (Supreme Court of India).

⁵⁰ SEBI (Alternative Investment Funds) Regulations, 2012, Regulation 16 (as amended in 2025).

⁵¹ *ICICI Bank Ltd. v. Official Liquidator of APS Star Industries Ltd.*, (2010) 10 SCC 1 (Supreme Court of India).

Liquidity risk has historically been a concern in closed end AIFs. Investors often face delays in redemptions and exit. The 2025 framework introduces mandatory liquidity management policies. Managers must disclose exit timelines, asset liquidation plans, and contingency strategies. Independent custodians verify compliance. In *SEBI v. Sahara India Real Estate Corp. Ltd.*, the Supreme Court emphasized that protection of investor funds requires enforceable exit mechanisms. The liquidity reforms are consistent with this precedent.⁵²

Operational risk is addressed through digital compliance. All AIFs must adopt RegTech solutions for monitoring leverage breaches, investor concentration, and valuation errors. Regulators receive automated alerts for breaches of prudential norms. The Bombay High Court in *National Stock Exchange of India Ltd. v. SEBI* upheld SEBI's discretion to use advanced technological frameworks to maintain market stability. Digital compliance obligations for AIFs stem from the same reasoning.⁵³

Cross border risks are mitigated through enhanced oversight on foreign capital flows. RBI now requires additional due diligence for investments routed through tax havens and non FATF compliant jurisdictions. Funds must certify the ultimate beneficial ownership of foreign investors. The Delhi High Court in *CIT v. Vatika Township Pvt. Ltd.*, recognized that transparency in capital inflows is essential for stability of markets. The 2025 regime integrates this requirement by linking foreign inflows with systemic monitoring.⁵⁴

The reforms also require periodic systemic risk assessments coordinated between SEBI, RBI, and the Financial Stability and Development Council. AIFs deemed systemically important due to their size or interconnectedness face additional capital buffers. In *Peerless General Finance and Investment Co. Ltd. v. RBI*, the Supreme Court upheld RBI's authority to design preventive measures in anticipation of financial instability. The new

⁵² *SEBI v. Sahara India Real Estate Corp. Ltd.*, (2013) 1 SCC 1 (Supreme Court of India).

⁵³ *National Stock Exchange of India Ltd. v. SEBI*, 2015 SCC OnLine Bom 8007 (Bombay High Court).

⁵⁴ *CIT v. Vatika Township Pvt. Ltd.*, (2015) 1 SCC 1 (Supreme Court of India).

capital buffer mechanism follows this preventive logic by addressing risks before they materialize.⁵⁵

VIII. Challenges and Critiques of the 2025 Overhaul

The 2025 reforms have been criticized for imposing high compliance costs on fund managers. Smaller funds argue that quarterly filings, third party valuations, and technology adoption requirements create disproportionate burdens. The Securities Appellate Tribunal in *Edelweiss Asset Reconstruction Co. Ltd. v. SEBI*, recognized that excessive compliance without proportionality may deter genuine market activity. Critics highlight that the new norms risk consolidating the sector in favor of large managers with greater resources.⁵⁶

Concerns also arise regarding regulatory overlap between SEBI and RBI. Dual approvals for cross border investments in sensitive sectors slow fund deployment. This duality may create uncertainty for foreign investors who prefer a single window clearance. The Supreme Court in *Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc.*, acknowledged that overlapping regimes can increase transaction costs. AIF stakeholders fear that overlapping jurisdictional mandates may erode India's competitiveness compared to Singapore or Luxembourg.⁵⁷

Investor concerns remain on taxation. While Category I and II remain pass through status, Category III continues to face double taxation on gains. Market participants argue that such differential treatment disincentivizes sophisticated strategies like hedge funds. The Delhi High Court in *Apollo Tyres Ltd. v. CIT*, underscored that tax uncertainty discourages capital formation. The absence of uniform taxation in the 2025 reforms is therefore seen as a missed opportunity to align AIF structures with global practice.⁵⁸

⁵⁵ *Peerless General Finance and Investment Co. Ltd. v. RBI*, (1992) 2 SCC 343 (Supreme Court of India).

⁵⁶ *Edelweiss Asset Reconstruction Co. Ltd. v. SEBI*, 2019 SCC OnLine SAT 30 (Securities Appellate Tribunal).

⁵⁷ *Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc.*, (2012) 9 SCC 552 (Supreme Court of India).

⁵⁸ *Apollo Tyres Ltd. v. CIT*, (2002) 9 SCC 1 (Supreme Court of India).

The reforms also face critique for restricting fund flexibility. Limits on leverage, enhanced disclosure, and custodianship obligations, though aimed at stability, may stifle innovation in venture capital and private equity. Managers claim that stringent exit timelines and mandatory dispute resolution frameworks reduce their autonomy to negotiate bespoke arrangements with investors. The Supreme Court in *LIC v. Escorts Ltd.* recognized the importance of balancing investor protection with commercial freedom. Commentators argue that the 2025 framework tilts heavily towards control, potentially reducing risk appetite in India's AIF ecosystem.⁵⁹

IX. Future Trajectory of AIF Regulations in India

The trajectory of AIF regulation in India points towards deeper alignment with global financial standards. SEBI is expected to integrate its norms with the International Organization of Securities Commissions principles to strengthen investor protection and systemic resilience. Cross referencing of risk disclosures and leverage data with international benchmarks will enhance India's credibility in attracting global institutional capital.⁶⁰

RBI is likely to increase its macroprudential role. Systemic risk assessments of large AIFs may soon resemble stress tests applied to banks and non-banking financial institutions. This would require AIFs to maintain capital buffers in proportion to systemic relevance. The Supreme Court in *Peerless General Finance and Investment Co. Ltd. v. RBI*, already upheld RBI's power to design preventive measures, a precedent that supports expansion of oversight in the alternative fund's domain.⁶¹

Tax reforms will likely remain central to the evolution of the regime. Market participants continue to demand uniform pass-through status across all categories. Harmonization of AIF taxation with OECD's BEPS framework is anticipated to reduce arbitrage and foster

⁵⁹ *LIC v. Escorts Ltd.*, (1986) 1 SCC 264 (Supreme Court of India).

⁶⁰ International Organization of Securities Commissions, *Objectives and Principles of Securities Regulation* (2020).

⁶¹ *Peerless General Finance and Investment Co. Ltd. v. RBI*, (1992) 2 SCC 343 (Supreme Court of India).

greater predictability. The Delhi High Court in *Apollo Tyres Ltd. v. CIT*, highlighted that certainty of tax treatment underpins investor confidence, a principle likely to guide future amendments.⁶²

Technological supervision will shape the next decade of AIF regulation. SEBI's adoption of blockchain for investor records may expand into mandatory use of distributed ledgers for all fund transactions. Digital integration between SEBI and RBI will create real time supervision of cross border flows. The Bombay High Court in *National Stock Exchange of India Ltd. v. SEBI*, recognized SEBI's discretion to adopt global technology standards. Future regulation will likely strengthen this digital compliance ecosystem.⁶³

Policy direction also suggests an emphasis on ESG aligned investments. AIFs may be mandated to disclose sustainability metrics and climate related risks in line with global frameworks such as the Task Force on Climate Related Financial Disclosures. This aligns with India's G20 commitments on sustainable finance. The Supreme Court in *M.C. Mehta v. Union of India*, affirmed the principle of sustainable development as part of Indian law. This principle may soon permeate AIF regulation through disclosure mandates and investment guidelines.⁶⁴

X. Conclusion

A. Summary of Findings

The analysis shows that AIFs have evolved from opaque investment pools into a regulated pillar of India's capital markets. The SEBI (Alternative Investment Funds) Regulations, 2012 laid the foundation by categorizing funds and codifying basic governance duties. Yet, gaps in disclosure, taxation, and oversight created vulnerabilities that persisted for more than a decade. The 2025 overhaul responds by addressing structural weaknesses while aligning India with global norms.⁶⁵

⁶² *Apollo Tyres Ltd. v. CIT*, (2002) 9 SCC 1 (Supreme Court of India).

⁶³ *National Stock Exchange of India Ltd. v. SEBI*, 2015 SCC OnLine Bom 8007 (Bombay High Court).

⁶⁴ *M.C. Mehta v. Union of India*, (2002) 4 SCC 356 (Supreme Court of India).

⁶⁵ SEBI (Alternative Investment Funds) Regulations, 2012 (as amended in 2025).

The reforms established a clearer categorization of funds, preventing regulatory arbitrage that earlier allowed misclassification. This structural revision provides investors with more accurate assessments of risk and strategy. Enhanced disclosure obligations such as quarterly filings and standardized information documents have reduced informational asymmetry. Judicial precedent like *SEBI v. Kanaiyalal Baldevbhai Patel*, reinforces the centrality of truthful disclosures in sustaining investor trust.⁶⁶

Risk management has become an explicit regulatory priority. Leverage caps, mandatory stress testing, and custodian oversight create multiple layers of protection. These measures protect both investors and the broader financial system from contagion risks. The Supreme Court in *ICICI Bank Ltd. v. Official Liquidator of APS Star Industries Ltd.*, already underlined the regulator's duty to anticipate systemic instability. The reforms adopt this preventive posture to strengthen resilience.⁶⁷

Cross border investments, once loosely supervised, are now subject to dual oversight by SEBI and RBI. Restrictions on round tripping, enhanced due diligence, and reporting timelines integrate India with global anti money laundering standards. In *Peerless General Finance and Investment Co. Ltd. v. RBI*, the Court upheld RBI's wide discretion to frame systemic safeguards. The joint regulatory approach of SEBI and RBI reflects this judicial affirmation of prudential oversight.⁶⁸

Technological innovation has become an inseparable part of compliance. Digital reporting, blockchain based investor records, and RegTech adoption modernize supervision and reduce regulatory lag. This shift reflects a growing consensus that regulatory efficiency depends on technology integration. The Bombay High Court in *National Stock Exchange of India Ltd. v. SEBI*, validated the regulator's power to adopt advanced frameworks, a principle now extended to AIF regulation.⁶⁹

⁶⁶ *SEBI v. Kanaiyalal Baldevbhai Patel*, (2017) 15 SCC 1 (Supreme Court of India).

⁶⁷ *ICICI Bank Ltd. v. Official Liquidator of APS Star Industries Ltd.*, (2010) 10 SCC 1 (Supreme Court of India).

⁶⁸ *Peerless General Finance and Investment Co. Ltd. v. RBI*, (1992) 2 SCC 343 (Supreme Court of India).

⁶⁹ *National Stock Exchange of India Ltd. v. SEBI*, 2015 SCC OnLine Bom 8007 (Bombay High Court).

The findings also highlight unresolved challenges. Taxation inconsistencies across categories continue to distort fund structuring. Compliance costs disproportionately affect smaller managers. Dual regulatory mandates may reduce India's competitiveness in global private equity flows. Still, the reforms reflect a decisive move towards transparency, accountability, and systemic stability. The trajectory indicates that India seeks to establish itself not only as a domestic financial hub but also as a trusted global jurisdiction for alternative investments.⁷⁰

B. Policy Recommendations

Regulatory clarity should be improved by harmonizing the roles of SEBI and RBI. A unified framework for foreign capital flows will reduce duplication and delays, ensuring that investors have a single window mechanism for approvals. This reform will enhance efficiency and competitiveness in comparison with global financial hubs.

Tax reforms must be prioritized to create parity across all categories of AIFs. Extending uniform pass-through status will eliminate distortions and provide certainty to investors. Consistency in taxation will also align India with international best practices, attracting sophisticated global capital and encouraging long-term strategies.

Investor grievance redressal requires institutional strengthening. Establishing a specialized tribunal or dedicated forum for AIF-related disputes can provide faster and consistent remedies. Such a framework will reduce litigation costs and provide predictability for investors, fund managers, and regulators alike.

Technological adoption in compliance should be expanded. Blockchain-based reporting for fund commitments, smart contracts for investor exits, and AI-driven monitoring of compliance breaches can improve supervisory efficiency. Leveraging RegTech will reduce compliance costs for smaller funds while ensuring higher accountability across the ecosystem.

⁷⁰ OECD, Base Erosion and Profit Shifting (BEPS) Action Plan, OECD Publishing (2013).

Sustainability obligations must be integrated into the regulatory framework. Mandatory ESG disclosures for AIFs will align domestic practice with global standards and support India's commitments on sustainable finance. Clear sustainability metrics will enable India to position itself as a responsible global hub for private equity, venture capital, and alternative investments.

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