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## CONTINUATION FUNDS: LEGAL STRUCTURING AND REGULATORY CHALLENGES IN INDIA

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### ABSTRACT

To solve the structural mismatch between fixed fund lifecycles and the extended maturation periods of high potential portfolio assets, continuation funds have become a popular private equity tool. Although market driven governance principles and regulatory monitoring have made these structures institutionalized in developed economies, their adoption in India is still in its infancy. The SEBI (Alternative Investment Funds) Regulations, 2012<sup>1</sup> were primarily created for fund formation rather than secondary restructuring transactions. This paper explores the legal and operational mechanics of continuation funds within the Indian private equity landscape and argues that their increasing relevance exposes critical gaps in the current regulatory framework.

The paper examines the fiduciary conflicts present in GP-led continuation fund transactions, namely the lack of required independent protections, information asymmetry, valuation opacity, and shortened investor approval deadlines. It also assesses how AIF rules interact with FEMA, FDI policy, taxation, and stamp duty issues, emphasizing transactional inefficiencies and procedural ambiguities. In order to protect investors while permitting GP-led value creation in India, the paper advocates targeted SEBI intervention through improved disclosure standards, independent valuation and fairness mechanisms, LP advisor oversight, and clearer consent procedures. It draws comparative insights from global practice to conclude that continuation funds require calibrated regulatory guidance rather than prohibition.

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<sup>1</sup> Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012.

## 1. Introduction

### 1.1 Background

Continuation Funds, in its most fundamental form, can be represented as a structural solution to a temporal problem that is intrinsic to the private equity model. When a General Partner (GP) manages a fund that is nearing the end of its stated life which is usually a ten-year investment period it still holds few portfolio assets that are yet to mature or haven't reached their maximum potential which can give an optimal exit value to the Limited Partners (LP). So, continuation fund mechanism allows the 'roll forward' of these assets into a newly constituted vehicle. So, rather than forcing a distressed sale of those assets at a value significantly lower than what it would be once it matures to unrelated secondary buyers, continuation funds ensures that the existing GP retains control over those assets whilst offering the LP's a choice to either cash out on their investments and exit or reinvest into the successor fund in which the asset will be now held to participate in future value creation.<sup>2</sup>

From the face of it the mechanics of Continuation Funds look quite simple but in reality, they are legally twisting. The assets are transferred from the old legacy fund to a new fund, usually with a fresh ten-year investment lifecycle. Some LPs from the legacy fund reinvest into the new fund are called as 'rolling LP's' while other LP's choose cash proceeds and exit from the investment. During the process many other institutional investors are also introduced. The GP retains its control over the management of the asset and its management fee entitlements though it is often negotiated given the reduced asset base and risk profile.

### 1.2 Central Problem

The foundational challenge underpinning continuation funds stems from what may be termed as 'temporal misalignment' between the lifecycles of funds and the maturity of investments. Funds under private equity operate on close ended structures which have a predetermined investment and liquidation period. This

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<sup>2</sup> Kobi Kastiel & Yaron Nili, *The Rise of Private Equity Continuation Funds*, ECGI Working Paper No. 733/2023, (Nov. 2023) <<https://www.ecgi.global/system/files/2024-04/the-rise-of-private-equity-continuation-funds.pdf>> (last visited Dec. 24, 2025).

investment period may last from about seven to ten years, and after its conclusion the funds enters into the liquidation period which is usually for about two to three years and is to harvest the remaining positions. The issue emerges when high potential and strategically sound assets cannot realistically be monetized within this window of liquidation period. As perhaps the portfolio company may require additional platform consolidation or the market conditions at that particular point of time are unfavorable for liquidating or the assets need some more time to reach its full potential.

At this stage, history shows us that GP's usually have limited options to proceed with: (i) they may hold the assets beyond the stated fund life which may lead to confrontation with LP's legal rights and lender covenants; (ii) they may sell the funds to other secondary buyers at a discounted price; or (iii) request for LP's consent to further extension. This is where Continuation Funds offer a new alternative to the GP; creation of a new vehicle, transfer of assets and resetting the clock.<sup>3</sup> Yet this elegance of continuation funds masks the profound legal and fiduciary complexities which are not adequately addressed in India's regulatory framework.

### 1.3 Significance in the Indian Market

In the past fifteen years India's PE ecosystem has matured remarkably, yet it still remains structurally developing as compared to other established markets around the world. Until recent times, continuation funds were almost unheard of in India, but three major converging developments have made them relevant in current times. First, the deployment of capital and formation of funds peaked between the years 2015-19, which signals towards the fact that may cohort of maturing PE funds now faced the classic scenario of continuation funds. Multiple assets in different sectors such as infrastructure, consumer platform, and software companies which were critical portfolio holdings of Indian PE funds remained undervalued on multiple bases and needed an extension in holding periods relative to the global precedent.<sup>4</sup>

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<sup>3</sup> Resolut Partners, *GP-led Secondaries in India – Considerations and Challenges*, available at <https://resolutpartners.com/research/gp-led-secondaries-in-india-considerations-and-challenges> (last visited Dec. 24, 2025).

<sup>4</sup> Chambers & Partners, *Private Equity 2025: Trends and Developments – India* (Sept. 11, 2025), available at <https://practiceguides.chambers.com/practice-guides/private-equity-2025/india/trends-and-developments> (last

Second, the maturation of institutional LP bases in India created investors who are sophisticated and long-term oriented and willing to commit themselves to extend timelines if such extensions guaranteed much better asset potential. This contrasted with the earlier eras where LP's pressure for exit was acute.

Third, the regulatory clarity surrounding Alternate Investment Fund (AIF's) under SEBI's post-2012 framework has provided a sufficient legal platform to contemplate structures which were previously impossible to comprehend. This along with tenure extension rules particularly for Large Value Funds, and growing investor sophistication created the conditions for continuation funds to exist and to be adopted.

#### **1.4 Research Objective**

This paper is going to examine the legal, regulatory, and fiduciary architecture which governs continuation funds under Indian Law, also identifying the lacunae, risks and policy recommendations. This paper is founded on the thesis that while continuation funds represent a legitimate and increasingly necessary tool for GP led value creation, but under India's current legal regulatory framework which is primarily designed for fund formation rather than secondary restructuring leads to the creation of substantial risks such as; conflict of interests without any present mitigating mechanism, information asymmetry between GPs and LPs and procedural uncertainty regarding investor consent, tax treatment and regulatory approval.

## **2. Analysis of Continuation Funds in the Global PE Markets**

### **2.1 Structural and Operational Mechanics**

Continuation Funds operate not through sale, but through asset transfer. Let's consider for example the legacy fund which is our Fund I holds portfolio assets worth around Rs. 100 Crores. The GP creates Fund II which is the continuation vehicle and solicits investment. Now, reinvesting LPs and new investors start to commit capital into Fund II. Hence, Fund I transfer its portfolio to Fund II, in

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visited Dec. 24, 2025).

consideration receiving cash proceeds equivalent to the negotiated valuation. Those proceeds are then distributed to LPs who exit, and the reinvesting LPs then apply their distribution to purchase the units now in Fund II.

From a tax liability perspective, the implications are non-obvious. As Fund I receives cash proceeds for the sale of its assets, it must report capital gains. If Fund II assumes the assets from Fund I on stepped-up basis, then subsequent gains are taxable once Fund II makes the exit. The key distinction in continuation funds is that the assets move from one fund to another, but the GP remains constant. This is in direct contrast with how secondary sales work, wherein assets are sold to unaffiliated secondary funds which are controlled by secondary GPs; continuation funds also sharply contrast with follow-on investments wherein the legacy fund makes incremental investments in the existing companies in the portfolio without making any restructuring in the fund itself.<sup>5</sup>

## 2.2 Trends in the Global Market and Prevalence

Continuation funds are emerging as a dominant tool in global PE markets, particularly since the year 2018. Industry data indicates that continuation funds are a growing component in the secondary market: continuation funds made up about 15% of sponsor-backed exit volume in 2023, up from 7% in 2022, indicating a larger trend towards GP-led liquidity solutions.<sup>6</sup> Particularly, in mega-fund denominations (more than \$5 billion Assets Under Management) continuation funds continue to be the most preferred exit pathway. The reasoning behind this is simple: rather than realizing a much smaller valuation in secondary auctions, it is better to let the GP maintain control and execute optimal exits and realize the maximum valuation to the LPs.

This trend has been explained by several structural drivers. Firstly, the sizes of funds have grown at a substantial rate, and many contemporary funds have now exceeded \$10 billion AUM, concentrating capital in fewer portfolio companies. Due to this concentration, secondary sale pricing becomes a less favorable option and

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<sup>5</sup> Income Tax Act, No. 43 of 1961, § 45 (India).

<sup>6</sup> Hargreaves Lansdown, *Key Trends in Private Capital Markets – Spring 2024* (2024), available at <https://www2.hl.com/pdf/2024/key-trends-in-private-capital-markets-spring-2024.pdf> (last visited Dec. 26, 2025)

continuation funds become more viable. Secondly, the typical time horizons for returns of LPs have extended with time, particularly for sovereign wealth funds, family offices now have around eight-to-twelve-year return horizon rather than the previous cycles of ten years. Thirdly, due to the mega fund competitions, GP expertise and operator networks now run increasingly deep; GPs over the time have proven to compound value through continued management rather than relying on secondary buyers.<sup>7</sup> However, this prevalence of continuation funds hasn't escaped regulatory notice. For instance, the U.S. Securities and Exchange Commission ('SEC') conducted various enforcement actions against GPs for the mishandling of continuation funds conflicts, and globally regulators have intensified the scrutiny, as the regulatory concern pretty much concentrates on – Are LPs receiving fair value under the transfer? Is consent genuinely informed? Are the conflicts being adequately managed?

### 2.3 Increased Regulatory Scrutiny and Intrinsic Rationale

Continuation funds present an elevated conflict of interest when compared with other PE transactions, which is recognized by regulators globally. In theory the rationale is pretty straightforward; the GP assumes antagonistic and simultaneous roles, i.e. in Fund I's capacity the GP must maximize the cash proceeds for the LPs that are exiting the fund, and in Fund II's capacity, the GP must minimize the acquisition cost in order to preserve Fund II's equity and maximize the available capital for operations. Both roles are fundamentally opposed.

More incrementally, the information asymmetry between the GPs and LPs favor the GPs more. As the GPs control all the material information regarding the performance of the asset, exit timing, and the prevailing market conditions. The LPs must decide whether they want to reinvest i.e. to accept the implicit representation of asset fairness by GPs within heavily constrained timeframes which is often weeks rather than months. This has also been documented by SEC wherein this decision window is usually between 14-21 days, materially constraining LPs diligence.

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<sup>7</sup> Bain & Co., *Global Private Equity Report 2024* (2024), available at [https://www.bain.com/globalassets/noindex/2024/bain\\_report\\_global-private-equity-report-2024.pdf](https://www.bain.com/globalassets/noindex/2024/bain_report_global-private-equity-report-2024.pdf) (last visited Dec. 26, 2025).

One of the other concerns is that of valuation, unlike in secondary sales where usually the market price emerges through bidding, continuation funds pricing is discretionary and negotiated. One of the most common instances is where the GPs have applied valuation multiples systematically in order to downplay the value of assets in the portfolio, which enabled them to acquire the LPs interests at a much lower price – which transferred the value from existing LPs to reinvesting LPs and the GP itself.<sup>8</sup>

#### 2.4 Indian Context and the Emerging Relevance

Until the year 2023, continuation funds were virtually non-existent in the Indian PE market. But, due to the convergence of several factors this equation has now shifted. Firstly, due to the peaking of India's PE fund formation in the years 2015-19, many cohort funds now face the classic continuation funds scenario. Secondly, the valuations in many portfolio companies have been extremely volatile and many assets in the portfolio remained under the entry valuations, which created reluctance among LPs to accept the exit below the entry pricing, which in turn made continued GP management attractive in contrast to secondary sales.<sup>9</sup> Thirdly, a few major segments in the Indian PE market such as infrastructure and mid-market segments have demonstrated longer value creation timelines. Operational initiatives such as management scaling, platform consolidation and regulatory remediation necessitate extended holding periods. As of now, India is still at an early stage when it comes to the regulating continuation funds compared to the global markets. This leads to emergence of both opportunity and risk; an opportunity to build a stronger regulatory outset for continuation funds by learning from the experiences of other global markets, without having to fix outdated rules later in time; and the risk of early transactions setting poor precedents or conflicts of interests if adequate regulatory rules are not in place for LPs protection.

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<sup>8</sup> Dechert LLP, *GP-Led Secondary Transactions: Mitigating Risk of Regulatory Scrutiny* (Oct. 31, 2019), available at <https://www.dechert.com/knowledge/onpoint/2019/10/gp-led-secondary-transactions--mitigating-risk-of-regulatory-scr.html> (last visited Dec. 27, 2025).

<sup>9</sup>Bain & Co., *Global Private Equity Report 2024* (2024), available at [https://www.bain.com/globalassets/noindex/2024/bain\\_report\\_global-private-equity-report-2024.pdf](https://www.bain.com/globalassets/noindex/2024/bain_report_global-private-equity-report-2024.pdf) (last visited Dec. 27, 2025); Lewis & Bockius LLP, *India's Private Equity Market Matures* (ION Analytics 2025), available at <https://www.morganlewis.com/-/media/files/news/2025/indias-private-equity-market-matures-ion-private-equity.pdf> (last visited Dec. 27, 2025).

### 3. Indian Regulatory and Legal Framework

#### 3.1 AIF's Structures in India and Their Role in Continuation Funds

Under SEBI's regulatory regime, AIFs are classified into three categories: Category I (Venture Capital, angel funds, social-venture, and infrastructure funds); Category II (Funds that didn't meet Category I criteria but contribute to the economic development); Category III (Hedge funds and funds that employ complex strategies).<sup>10</sup> In the absence of specific regulatory guidance, continuation funds would typically fall within Category II (PE Funds). By their nature AIFs are mandatorily close ended vehicles, which have an investment period of typically five to seven years, and this is followed by a liquidation period of around two or three years. The distribution of cash proceeds must be completed within this liquidation period absent extension. Due to its nature of being a close ended structure, it creates a temporal constraint which further motivates continuation funds.

The *SEBI (Alternate Investment Funds) Regulations, 2012* governs AIFs management, dissolution and formation. The Master Circular for AIFs (amended May 2024) operationalizes these regulations, and provides detailed guidance on valuation, investor consent, tenure and extension.

#### 3.2 Major Regulatory Provisions Affecting Continuation Funds

Regulation 13(5) of SEBI (Alternate Investment Funds) Regulations, 2012 permits extension of tenure of close-ended funds by up to two years, provided the approval of two-thirds of the unit holders by the value of their investment in the AIF and for Large Value Funds ('LVFs') as informed by SEBI in Para 6 in its 'Circular dated December 08, 2025', SEBI explicitly interprets Regulation 13(5) of SEBI (Alternate Investment Funds) Regulations, 2012 and permits the extension of tenure of LVFs by up to five years subject to the approval of two-thirds of the unit holders by the value of their investment in the LVF for accredited investors.<sup>11</sup> The SEBI'S

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<sup>10</sup> Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, reg 3(4) (a)-(c) (India).

<sup>11</sup> Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, reg. 13(5) (India); Securities and Exchange Board of India, Circular No. HO/19/34/11(5)2025-AFD-POD1/I/188/2025 (Dec. 8, 2025).

Regulations in particular does not include any provision which addresses continuation funds specifically. Under SEBI's regime continuation fund would technically constitute a new AIF (Fund II), which would trigger fresh registration, disclosures, investor approvals etc. Due to this absence of regulations that would deal specifically with continuation funds, creates procedural ambiguity. For instance, what are the conditions under which Fund I can transfer its assets to Fund II? How will this transfer of assets be taxed? Such questions lack a clear regulatory answer in the Indian framework.

According to the Master Circular (as amended September 2024), AIF investments must be appraised using methods that adhere to fair value principles and utilize qualified valuation specialists.<sup>12</sup> However, the framework is somewhat lax. Internal valuations by qualified professionals are appropriate in certain situations; independent valuers are not always required. This laxity poses a risk for continuation fund transactions because, in the absence of required independent valuations, general practitioners might use self-serving approaches without external restraints.

Two-third of unit holders by investment value must approve material changes to fund terms. Transactions involving continuation funds, such as asset transfers and restructuring, would most likely be considered major modifications. However, in the regulations there are no specified disclosure requirements or deadlines for requesting consent or any procedure for minorities who disagree. This procedural vulnerability results from the lack of these specifications; transactions might hypothetically be carried out with technical conformity to a two-thirds vote requirement without actual informed consent.<sup>13</sup> The AIF Regulations limit transactions between related parties and set broad conflict of interest rules for fund managers. However, rather than secondary restructuring, these clauses were written with typical fund operations in mind. Yet it remains unclear whether related party limitations apply to continuation funds transactions, wherein the GP is both the

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<sup>12</sup> Securities and Exchange Board of India, *Master Circular on Alternate Investment Funds* para. 22 (May 7, 2024); Securities and Exchange Board of India, Circular No. SEBI/HO/AFD/AFD-POD-1/P/CIR/2024/111 (Sept. 19, 2024).

<sup>13</sup> Securities and Exchange Board of India, *Master Circular on Alternate Investment Funds* paras. 2.5.4 – 2.5.5 (May 7, 2024).

buyer and the seller in the transaction at the same time. So, does this limit apply? And if so, how should the GP balance both these roles?<sup>14</sup>

For independent valuations and due diligence, although independent appraisals are required under SEBI's Master Circular in certain situations (including fund dissolution), this requirement is not always present. Independent fairness evaluations and third-party valuations are optional rather than required for continuation funds transactions because SEBI has not made them necessary.

### 3.3 FDI and FEMA Considerations

Foreign fund participation in continuation funds transactions adds complexity to FDI policies and FEMA Regulations. FEMA pricing requirements are applicable if foreign investors take part in Fund II, either as new investors or as reinvesting LPs from Fund I structure containing foreign investors.<sup>15</sup>

Rule 21 of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 sets fair market value standards for primary issuances to foreign investors.<sup>16</sup> There are further restrictions on secondary transfers between residents and non-residents. FEMA issues arise when Fund I (managed by Indian GP, possible with foreign LP ownership) transfers assets to Fund II and foreign LPs reinvest at prices below fair market value prices. Furthermore, the entrance of new foreign investors to Fund II must overcome sectoral limits if the portfolio assets in Fund II have limitations on foreign investor holdings. Practical limitations result from this: Fund II entrance of foreign additional capital may be prevented in the absence of sectoral headroom if Fund I contained foreign investor involvement limited to specific asset clauses.

### 3.4 Tax Consequences and Structuring

In India, the tax classification of continuation funds is still very unclear, which could lead to disputes.

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<sup>14</sup> Securities and Exchange Board of India, *Master Circular on Alternate Investment Funds* para. 23.1.6 (May 7, 2024).

<sup>15</sup> Foreign Exchange Management (Overseas Investment) Rules, 2022, r. 17 (India).

<sup>16</sup> Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, r. 21 (India).

Fund Level Taxation – Fund I must record capital gains when it transfers assets to Fund II in exchange for cash proceeds. Fund I capital gains taxation is triggered by this event. But, if Fund I is classified as Category I AIF, it benefits from pass-through status, which potentially means that gains flow through to LPs and there is no fund tax. But this transfer event in itself is a gain recognition obligation that needs to be computed and possibly reported, which adds to the administrative and regulatory responsibilities.<sup>17</sup>

Taxation of LPs – Reinvesting LPs invest the asset transfer revenues they receive from Fund I into Fund II at the same time. The LP records a gain in Fund I, establishes a new cost basis in Fund II units, and starts new holding periods if the reinvestment takes place in the same year as distribution. In comparison to a single fund extension, this may be inefficient due to the cascading of taxes repercussions over many funds.

Complications for current Fund I foreign LPs include the need to verify treaty benefits and credit procedures if distribution results in withholding tax obligations and reinvestment takes place through an offshore structure. A Fund I with a multi-jurisdictional foreign LP base must manage unique tax treatment for each LP class because different treaty jurisdictions apply different regulations.

Incentive and Rollover Provisions – Unlike some jurisdictions that offer preferential treatment for reinvestment, as of now India does not officially recognize “rollover” relief for continuation fund transactions. This means that reinvesting LPs do not obtain a tax deferral on distributions reinvested, transferred assets do not receive a cost basis step-up without incurring tax, and continuation funds do not receive any specific tax advantage in contrast to ordinary secondary sales.

Transfer and Stamp Duty Implications – Transfers of portfolio investments from Fund I to a continuation fund vehicle may attract stamp duty depending on the nature of the assets and transfer structure. Where transfers are effected through equity share transfers, stamp duty is generally levied at the securities transfer rates prescribed under the Indian Stamp Act regime, which are relatively low. However,

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<sup>17</sup> Income Tax Act, No. 43 of 1961, §§ 45, 115UB(1) (India).

higher stamp exposure may arise if the transaction involves transfer of immovable property or business undertakings. Cross-border continuation transactions may also raise transfer pricing and valuation considerations, particularly where related parties are involved.

#### 4. Significant Policy and Legal Issues with Continuation Funds

##### 4.1 Complexities of Fiduciary Duty and Conflict of Interests

The GPs concurrent adoption of conflicting tasks is the primary legal difficulty in Continuation funds. A GP own 'fiduciary duty' to fund investors under the fiduciary law that applies to AIFs, which is derived from trust law principles, contract law interpretation of fund documents, and increasingly, regulatory guidance. These obligations have been identified by scholars as follows: (i) duty of care (act with competence and diligence); (ii) duty of loyalty (subordinate personal interests to LP interests); (iii) duty of honesty (disclose material conflicts); and (iv) duty of fairness (treat similarly situated investors evenly).<sup>18</sup>

The GP's responsibilities differ in continuation fund transactions. The GP is responsible for maximizing exiting LP revenues in their capacity as Fund I manager. The GPs job as Fund II manager is to maximize the amount of capital available for assets operations while minimizing acquisition costs. There is a direct conflict between these responsibilities. By definition, a pricing mechanism that benefits Fund II hurts leaving LPs.

Self-Dealing Doctrine – Self-dealing transactions are subject to increased scrutiny under equity jurisprudence. Traditionally, when a fiduciary deals with itself, it is considered as self-dealing. A more complex self-dealing situation is presented by continuation funds, where the parties are theoretically separate legal entities (Fund I and Fund II) yet the fiduciary controls both the sides. But the controlling GPs economic self-interest is still the same. Self-dealing scrutiny has often been applied by courts looking at parallel scenarios, demanding increased disclosure, fairness

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<sup>18</sup> *Lysaght v. Lysaght*, [1900] 2 Ch. 231 (C.A.).

assessment, and independent valuation.<sup>19</sup>

Corporate law and trust law are the main sources of Indian jurisprudence on fiduciary duty. English equity principles are applied in the former, whereas company law standards are applied in the latter. In both traditions, fiduciaries are subject to strict obligations, and violations are punishable by equity. The decision in *Sangramsinh P. Gaekwad & Ors. v. Shantadevi P. Gaekwad & Ors.*<sup>20</sup> affirms that fiduciary relationships attract heightened standards of loyalty, good faith and care, breach of which may invite equitable scrutiny and corrective reliefs by courts, particularly in cases which involve abuse of control. In recent times Indian courts have started to include responsibilities of good faith and fairness. The NCLT has acknowledged that equity may necessitate further transparency and fairness requirements if there are conflicts, even in cases where contracts technically allowed specific action.

The Growing Understanding of “Manager/Sponsor Obligations” by SEBI: According to the master circular, the AIF manager is responsible for “due diligence,” “disclosure,” and “investor protection.” These are presented more as regulatory requirements than as stringent legal obligations. However, SEBI has shown that it is prepared to strictly implement these requirements. Although not specifically required by the obligations, SEBI enforced stricter disclosure standards and conflict-management provisions in the case of co-investment programs.<sup>21</sup> Despite the current regulatory silence, this pattern indicates that SEBI may independently enforce continuation fund standards.

#### 4.2 Pricing and Valuation Mechanisms

In continuation funds, valuation serves as the primary risk vector. Pricing is determined through discussion between Fund I (represented by its GP) and Fund II (represented by the same GP); there is no objective external price. GPs have

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<sup>19</sup> Kevin Cole, *An Unfinished Agenda: The Role of Fairness Opinions in Controlling Management Self-dealing* 49 UCLA L. Rev. 1 (2001).

<sup>20</sup> *Sangramsinh P. Gaekwad & Ors. v. Shantadevi P. Gaekwad*, (2005) 11 S.C.C. 314 (India).

<sup>21</sup> Securities and Exchange Board of India (Alternate Investment Funds) Regulations, 2012, reg. 17A (India); SEBI, Securities and Exchange Board of India, Circular No. SEBI/HO/AFD/AFD-POD-1/P/CIR/2025/126 (Sept. 9, 2025).

significant latitude to determine valuations that benefit Fund II and themselves in the absence of outside restrictions.

Methods of valuation according to IPEV Guidelines: The IPEV Guidelines, which incorporates international best practices, suggests evaluation fair value using the following methods: (i) market approach (similar transaction multiples, trading comparables); (ii) income approach (DCF, residual cash flow); and (iii) replacement cost approach.<sup>22</sup> Single methodology values are not recommended; multiple methods should be harmonized.

Lack of Market Check Requirement: Continuation funds usually do not have market checks, in contrast to secondary sales using auction methods which offer external price discovery. The GP and current LPs engage in bilateral price negotiations. Significant agreements in developed markets such as the US and the UK frequently use fairness judgements from independent investment banks that offer benchmark values, market testing, and explicit fairness recommendations. Deals are carried out using internal values and GP representations; Indian continuation funds have not established this practice.

#### **4.3 Minority Protection, LP Consent and Voting**

For significant changes, two-third LPs approval is required per SEBI Regulations. It is obvious that continuation funds would be considered as material modifications. However, India still lacks several safeguards that are common in developed markets.

Disclosure Standards and Timing Windows – Information rights are not specified by the Regulations, but voting thresholds are. How much time do LPs receive to perform diligence? There is no solution to this in the Regulations. Compared to the global norms (usually 30-60 days), current practice appears to be 14-30 days period

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<sup>22</sup> Int'l Private Equity and Venture Capital Valuation Bd., *International Private Equity and Venture Capital Guidelines* (2025), available at <https://www.privateequityvaluation.com/Portals/0/Documents/Guidelines/2025%20IPEV%20Valuation%20Guidelines.pdf> (last visited Dec. 28, 2025); Ernst & Young LLP, *International Private Equity and Venture Capital Valuation Guidelines (IPEV): Key Valuation Principles* (Nov. 2023), available at <https://www.ey.com/content/dam/ey-unified-site/ey-com/en-in/services/strategy-transactions/images/valuation-modeling-economics/ey-international-private-equity-and-venture-capital-valuation-guidelines.pdf> (last visited Dec. 28, 2025).

for LP diligence and decision making, which is significantly constricted. LPs diligence capacity is significantly hampered by short windows, especially for foreign LPs that operate across time zones and on top of that have complex tax and structural issues.<sup>23</sup>

**Dissenting LP Rights** – The Regulations do not establish appraisal rights or dissenter remedies, although they do set voting thresholds. A dissenting LP has a few options if they vote against a continuation fund transaction and the deal still receives the required two-third approval. The LP has three options: (i) accept the transaction and hope for vindication through later asset performance; (ii) pursue any redemption or withdrawal rights; or (iii) file a lawsuit for the breach of fiduciary duty, which is an expensive and uncertain remedy. In significant mergers, mature markets often grant dissenting LPs improved exit rights or appraisal remedies. The framework in India offers neither.

**Requirement for Unanimity** – It is still unclear if continuation fund transactions call for unanimity rather than supermajority. Unanimity requirements for “sale of substantially all assets” or similar phrases are found in some fund documents, especially older legacy documents. One could argue that a continuation fund qualifies as an asset transfer for unanimity. However, such contractual unanimity clauses may be superseded by SEBI’s supermajority requirement (two-thirds). Compliance risk is caused due to this legal ambiguity.

**Threat of Coercion** – Coercion risk persists even in cases of official voting compliance. GPs have a significant impact on the LP behavior. Continuation funds may be presented by the Fund I manager as ‘necessary’ to achieve the full value, suggesting that rejection compels unfavorable secondary sales. The GPs choice of new Fund II investors and its portrayal of reinvestment as the ‘smart’ alternative have a huge impact on the reinvestment selections. Due to these informal benefits, there is a slight risk of coercion; LPs vote ‘yes’ based on GP-induced perceptions that alternatives are rather worse than true conviction.

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<sup>23</sup> Institutional Ltd. Partners Ass’n, *Continuation Funds: Considerations for Limited Partners and General Partners* (May 2023), available at <https://ilpa.org/wp-content/uploads/2023/05/Continuation-Funds-Considerations-for-Limited-Partners-and-General-Partners.pdf> (last visited Dec. 29, 2025).

#### 4.4 Structuring and Tax Complications

As previously highlighted, continuation funds taxation is still quite unclear. In comparison to fund extension options, the compounding of several tax levels (Fund I level, LP level, rollover issues) results in efficiency losses.

Complications with Transfer Pricing and Foreign LPs – Transfer pricing is important when continuing funds are used for foreign LP reinvestment. Are Fund I and Fund II's assets priced at arm's length? Transfer price paperwork must enable pricing if foreign entities are related parties. Related-party transactions involving cross-border flows are scrutinized under India's transfer pricing legislation; continuation fund transactions may result in paperwork and audit risk. Further, tax disputes may arise from valuation disagreements between LPs and GPs about continuation fund pricing. Fund I will be subject to an unforeseen tax penalty on a bigger capital gain if the transfer from Fund I to Fund II, let's say happens at Rs. 100 Crores, but tax authorities contest and reevaluate at Rs. 120 Crores. This results in a potential tax liability that was not recognized at the time of the transaction and redistributes value from LPs to the state.

#### 4.5 Procedural Ambiguity and Regulatory Vacuum

The main issue is that secondary restructuring was not intended to be governed by the SEBI (AIF) Regulations, which were created to regulate fund formation and conventional operations. Continuation funds are not specifically forbidden, but they also lack specific regulatory guidelines, leaving them in a regulatory vacuum. This leads to ambiguity in certain areas such as: (i) Procedure – Which steps are necessary for a continuing fund transaction? Which regulations are necessary? Fund II needs to register and Fund I need to wind down. However, the sequencing and the simultaneity are still unknown; (ii) Independent Committee Requirement – Independent board committees, or independent fairness committees in partnership arrangements, are commonly used in US practice to examine continuation fund transactions. There is no comparable requirement in India. Investment committees which are usually made up of fund professionals and investors chosen by the GP, are employed by several advanced Indian AIFs. It is uncommon to be truly independent; (iii) Disclosure Structure – Continuation fund transactions do not

follow a set disclosure structure. Disclosures differ; some funds just provide aggregate NAV figures, while others offer thorough asset-by-asset assessments; and (iv) Market check requirements – Neither market testing nor third-party valuation are required. In the absence of external price discovery, deals are carried out at agreed-upon prices. This regulatory void results in investor protection gaps (LPs lack clear standardized information and protection procedures) and transaction execution risk (deals happen without clear regulatory clearance channels).<sup>24</sup>

#### **4.6 Information Asymmetry and Investor Protection**

There is a basic and structural information disparity between GPs and LPs. GPs have complete control over all the relevant data, including operational difficulties, exit timing preferences, management team compatibilities, specific asset performance, and alternative transaction structures. LPs do not have access to board materials, internal management discussions, or real-time operational updates, although they do receive quarterly reporting. Information asymmetry is magnified in the continuation fund scenarios. LPs must determine whether reinvestment in Fund II is reasonable and whether the GPs valuation is fair (usually within 14-30 days). GP-provided valuations, GP-provided asset performance updates, public business listings (if the portfolio companies are public), and LP-commissioned independent values are the LPs information sources. The arrival of information is GP-controlled and asymmetric.

According to US practice, which is now standard in SEC guidance, continuation fund sponsors must provide – (i) comprehensive asset valuations with supporting methodologies; (ii) executive summary of valuation assumptions; (iii) explicit conflict of interest disclosure; (iv) fairness opinion (a third-party investment bank's assessment that the transaction is fair from financial perspective); and (v) LP advisor committee review (a committee of independent LPs provide governance oversight). These safeguards are absent from India's AIF framework. Advisory panels may be included in fund documentation, but they are optional and seldom used (especially in PE funds, where GPs desire operational autonomy). Opinions

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<sup>24</sup> Kastiel & Nili, *supra* note 2. And ILPA: Institutional Ltd. Partners Ass'n, *supra* note 23.

on fairness are uncommon and standards for disclosure are not uniform.

When used, LP advisory panels offer significant investor protection for continuation funds. The acquisition is reviewed, an independent valuation is obtained, and non-binding advice is given by a committee consisting of three to five independent LP representatives. Although advisory committee recommendations are not legally binding, GPs who disregard them pose a risk to their reputation. Advisory panels are not required by India's system, which creates a significant protection gap.

#### **4.7 Various LP Classes and Negotiation Dynamics**

LP classes are treated differently because of continuation fund transactions. LPs that are leaving aim to maximize cash proceeds and pursue liquidity. Reinvesting LPs want lower reinvestment pricing and aim for upside participation. Although they may have different risk profiles or expectations for returns, new investors provide more funds. This raises the probability of unfair treatment. In comparison to leaving LPs, the GPs may selectively structure the transaction to benefit reinvesting LPs (by establishing lower prices)? Is it possible to structure new investor participation to dilute current LPs? Answer is yes, in the absence of defensive measures.

In the absence of explicit justification, equal treatment requirements are imposed under trust law and partnership law. Every beneficiary who is in a comparable situation ought to be handled fairly. All Fund I unit holders should get equitable treatment in continuation fund circumstances, which entails consistent exit prices, comparable reinvestment terms, and the same valuation for each unit. However, if LPs bargain separately with GPs, it may result to different terms or prices.

### **5. Conclusion**

As fund portfolios grow and asset value generation transcends conventional fund lifecycles, continuation funds become a more significant structure for Indian private equity. The approach is economically rational since it prevents distressed secondary sales, preserves operational continuity, and allows skilled GPs to create more value.

However, there are significant inadequacies in India's current regulatory structure. The SEBI (Alternate Investment Funds) Regulations, 2012 offer little guidance on continuing fund operations, valuations, investor consents, and conflict management because they were created for fund formation rather than secondary restructuring. This regulatory void exposes LPs to protection gaps, raises transaction risk, and produces legal uncertainty.

Conflict of interests between the GPs dual roles in Fund I disposer and Fund II acquirer, valuation opacity in the absence of independent verification, information asymmetry limiting LP diligence, procedural ambiguity regarding consent and disclosure, and tax complexity resulting in cascading LP-level inefficiencies are the main risks. These risks can be significantly mitigated through regulatory guidance or best-practice standards, but they are not fatal to continuation funds. Clear models are provided by the developed market experiences (the United States, United Kingdom, and the European Union): independent valuations, fairness views, LP advisory committees, improved disclosure, and prolonged consent timing all produce significant investor protection.

Regulatory guidance, as opposed to outright restriction, is the best course of action. A special circular addressing continuation fund operations, defining independent valuation standards, outlining expectations for fairness opinions, mandating LP advisor committee review and standardizing disclosure should be released by SEBI. As an alternative, continuation fund features could be incorporated into a modernized AIF framework in the upcoming AI Fund consultation (cited in November 2025 regulatory events). The timing is crucial. Continuation fund deals will rise as India's PE develops. It is much better to create clear regulatory limitations now, while the market is still in its infancy, than to retrofit laws after negative precedents have been established. India has the chance to create continuation fund arrangements that allow for real value creation while shielding investors from conflicts and opacity by taking a cue from the experiences of more developed markets.