

Review of Regulatory Framework for Sponsors of a Mutual Fund

1. Objective:

1.1. This Board Memorandum proposes to amend SEBI (Mutual Funds) Regulations, 1996 (hereinafter referred as “MF Regulations”), to introduce a regulatory framework for sponsor(s) of a Mutual Fund (MF) to enable diverse set of entities, to be associated with the Mutual Fund industry with requisite safeguards in place, who otherwise may not have been eligible. The Memorandum also proposes “Self Sponsored AMCs” where original sponsor would have voluntarily disassociated itself.

2. Background:

2.1.A ‘Sponsor’ means any person who, acting individually or in concert with another body corporate, establishes a mutual fund. The Sponsor is responsible for all the steps for setting up and registering a MF with SEBI such as establishing Mutual Fund trust under the Indian Trust Act 1961, incorporating and setting up Asset Management Company (AMC) and trustee company as per the conditions of the SEBI in-principle approval etc.

2.2. In the current Regulatory framework, sponsors inter alia need to have adequate experience in financial services, sufficient net worth, profitability requirement etc. while setting up a mutual fund. Therefore, only sponsors with experience and adequate financial wherewithal, qualify for setting up MFs. In view of the changing landscape of the MF industry, in 2021, a proviso was included in the MF Regulations so that an applicant, not meeting the profitability criteria, could also act as sponsor of a MF, provided that the applicant had a positive net worth of not less than rupees one hundred crore and the net worth of the AMC was mandated to be not less than rupees one hundred crore and the asset management company shall maintain such net worth till it has profits for five consecutive years.

2.3. In order to enhance the penetration of the Mutual Fund industry, a need has been felt to facilitate new players, who may find difficulty in meeting eligibility norms to act as sponsor, by introducing an alternative set of eligibility criteria.

This is expected to facilitate fresh flow of capital into the industry, foster innovation, encourage competition and provide ease of consolidation and easing exit for existing sponsors.

2.4. Over the years, the mutual fund industry has evolved and the AMC's have now gained significant maturity. This is evident from the fact that more than 90% of the AMC's have already completed more than 5 years of operation, have 5 year financial services track-record and sufficient net worth. Consequently, sponsors' obligations have been gradually reducing to technical activities (signatory to trust deed). This scenario is captured below:-

Table 1- Evolution of regulatory landscape vis a vis the role of sponsor

Sl. No.	In 1990s	In 2022
1	MF regulations provides that no guaranteed returns shall be provided unless such returns are fully guaranteed by the sponsor, or a statement is made indicating the name of the person guaranteeing , or manner of meeting the guarantee is stated in SID.	Guaranteed return schemes are not being offered by MFs and given the risk associated with such schemes, going forward, the provision for such schemes is proposed to be deleted. Hence, sponsor's role in this context will not be relevant.
2	Experience in financial service for a period of 5 years was needed to enable the management of MF efficiently, since it was a new asset class in the country.	Several AMC's have developed enough in-house experience. The MF industry itself has abundant talent now, for new MFs as well.
3	Eligibility criteria of Sponsor w.r.t sound track record, fit and proper criteria etc. were necessary when a new business is set up.	AMC's have their own track record of performance and have become independently eligible to be sponsors.
4	Sponsor needed to contribute a minimum 40% of the net worth of the AMC at the stage of its setting up.	AMC's have accumulated sufficient liquid assets on their own over years of operation.
5	Trust Deed is executed between the Sponsor and Trustees governing the operations of the mutual fund trust.	The MF business has gained sufficient maturity and provisions of trust deed have become standardised over the years no longer requiring frequent changes.
6	Sponsor's brand/ reputation was needed to set up a mutual fund. (The further information in this part is excised.)	Over the years, most of the mutual funds have developed brand/ reputation of their own and new MFs will deploy their new brand building initiatives.

7	Sponsor was the primary entity that sets up a mutual fund. Sponsor was relevant in initial years as well as on an ongoing basis.	Sponsor is relevant in initial years for a new mutual fund but not on an ongoing basis. A sponsor is also not needed in a mature AMC. For new AMCs, adequate funds if available, can facilitate access to all necessary resources which are available at an Industry level.
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The table above shows the paradigm shift in 3 decades warranting reduction in the role of sponsors in AMCs.

Separately, the existence of a sponsor who is in a strong position to influence the activities and decisions of the AMC has often been questioned in the regulatory context in terms of conflicts of interests between sponsor and unit holders of the MF. The various instances of possible / existing conflicts of interests were paced before a WG and were also discussed in the MFAC. Based on the deliberations, the table below gives the benefits arising from a reduction in sponsor stake in AMC and the costs of reduction in stake.

Table 2: Reduction in influence of sponsor over AMC- cost benefit analysis

Benefits	Adverse effects
<ul style="list-style-type: none"> a. Reduction in Sponsor-related Conflict: The influence of the Sponsor in the AMC and Trustee are directly proportional to the shareholding held by it. With reduction in stake of the Sponsor, the influence is likely to reduce. b. Strategic Guidance: The presence of other significant shareholders may bring in strategic guidance and good talent to fuel growth and innovation, and expand 	<ul style="list-style-type: none"> a. Increase in Agency Problems: With Sponsor holding majority control over the Mutual Fund, it is in position to diffuse all other Agency Problems (such as Management related conflicts). b. Absence of Trusted Brand Names: If the Sponsor's stake in AMC reduces below the 50% threshold, most of the trusted names in Indian Mutual Fund industry may no longer be able to continue with their Group Name. Considering that a trusted Group Name is one of the major factors in investors choice of mutual fund, this will adversely affect the industry as a whole. c. Conflict among Multiple Shareholders: The misalignment of interests among multiple Investors can lead to stalemate in decision

<p>the presence of mutual funds including driving inclusive growth. These will lead to better value for everyone.</p> <p>c. Improved Corporate Governance: The other investors usually will have some board representations due to their substantial investments in the Mutual Funds, thereby improving overall corporate governance of the mutual funds.</p> <p>d. AMCs will be more aligned to the unit holders' interests: Due to presence of other Investors in AMC, Mutual Funds will have less related party transactions. This would indirectly also benefit the unitholders.</p>	<p>making or even worse value-dilutive decision making arising out of competitive behaviour.</p> <p>d. Short-term focus: Financial Investors do not have sponsor-like obligations and their interest in the mutual funds is only financial. This can lead to a situation where Investors are pushing the mutual fund to more and more risky path for higher returns.</p> <p>e. Compromise on the Stability of the Mutual Fund: The Investors usually have an investment horizon of a few years which would lead to higher churning of controlling shareholders and higher uncertainty about the vision and culture in the Mutual Funds.</p> <p>f. Demotivating Serious Entities: With mandatory reduction of stake requirements, the serious entities may not be interested in selling up stakes in Mutual Funds.</p> <p>g. Not enough Investors available: Considering that there may not be enough Investors who are interested in Mutual Fund Business and meet Fit and Proper restrictions, such reduction may not be possible across the Mutual Fund Industry.</p> <p>h. Attracting human capital: Talent acquiring is generally dependent upon Sponsor's strength and their commitment in building the AMC business plays a very key role in attracting good talent to run the AMC.</p>
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2.5. Accordingly, a working group was formed by SEBI to examine the aforesaid issues. Recommendations of the Working Group were placed before the Mutual Fund Advisory Committee ('MFAC'). The recommendations of MFAC were suitably incorporated and a consultation paper was issued in this regard.

3. Public Consultation:

3.1. SEBI placed a consultation paper on “Review of Regulatory Framework for Sponsors of a Mutual Fund” on January 13, 2023, on its website, seeking public comments on the proposals made therein, including Eligibility Criteria for Sponsor, Alternate eligibility criteria to become a sponsor, Private Equity Funds/ Pooled Investment Vehicles/ Pooled Investment Funds (PE) as Sponsor, Role of Sponsor after AMC matures, Self-Sponsored AMC, etc.

3.2. In response, more than fifteen comments have been received from public including various stakeholders such as Association of Mutual Funds in India (AMFI), AMCs, law firms, intermediaries etc. Several observations were made in the media also. The consolidated comments received as on January 29, 2023, are placed at **Annexure A**.

4. Regulatory changes pursuant to consultation paper.

Taking into consideration the comments received on the consultation paper from various market participants including AMFI, media and recommendations of the MFAC, the following regulatory changes are proposed:

4.1. Eligibility Criteria for Sponsor

A. Suggestion in the Consultation Paper

The main eligibility criteria for a sponsor w.r.t sound track record under the existing route at Regulation 7 of MF Regulations may be modified as under:

- a.** The existing requirement of carrying on business in financial services for a period of not less than five years may be continued with.
- b.** The existing requirement of positive net worth in all the immediately preceding five years may be continued with. However, the said net worth shall be in the form of positive liquid net worth¹.

¹ *Liquid net worth means net worth deployed in liquid assets which are unencumbered. A liquid asset is an asset that can easily be converted into cash in a short amount of time. Liquid assets include things like cash, money market instruments, Government Securities, T-bills and Repo on Government Securities.*

- c. The existing requirement that the net worth of Sponsor be more than the proposed capital contribution in the asset management company shall continue. However, the said net worth shall be in the form of positive liquid net worth.
- d. In case of change in control of the existing asset management company due to acquisition of shares, sponsor should be able to demonstrate the firm commitment (by way of having positive liquid net worth or tying up of funds) to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher.
- e. The existing requirement of profits after providing for depreciation, interest and tax in three out of the immediately preceding five years, including the fifth year may be reviewed as under:

The sponsor should have

 - (i) Net profit after providing for depreciation, interest and tax in each of the immediately preceding five years; and
 - (ii) Average net annual profit after providing for depreciation, interest and tax during the immediately preceding five years should be at least INR 10 cr.
- f. All other existing requirements (including Fit and Proper Requirements) are adequate and may not be modified. Fit and Proper Requirements have been recently reviewed by SEBI for all intermediaries by way of amendment to SEBI (Intermediaries) Regulations, 2008.
- g. The minimum positive liquid net worth requirement of AMC (INR 50 cr.) shall be required to be maintained on a continuous basis. The sponsor shall be responsible to ensure that AMC is in compliance with maintaining minimum positive liquid net worth.

B. Public Comments:

The main comments received are summarized below:

- a. Banks and all existing sponsors may be exempted from "Positive Liquid Net Worth (PLNW) criteria, because banks already maintain liquid assets or a glide path may be provided as per RBI norms.
- b. The PLNW should be restricted only to 40% (being minimum contribution for Sponsor) of AMC's minimum net worth requirement. SEBI may clarify the minimum threshold which should be held in form of "liquid" net worth. SEBI should ideally impose the positive liquid net worth requirement only at the time of applying, or extending up to the preceding year.
- c. Proposed calculation of Liquid Net Worth should consider the AMC Investments in schemes (as a part of alignment of interest), marketable securities such as listed securities and open ended investment funds etc., mutual fund units as part of the Liquid Net Worth.
- d. Once the AMC is capitalized by the sponsor, the AMC will spend / invest such funds for various operational purposes. Therefore, the reference of having 'liquid net worth' should only be applicable to the sponsor for the purposes of SEBI approval and should not be imposed on the AMC.
- e. The net-worth based eligibility criteria defeats the purpose by erecting high entry barriers for interested players.

C. Consideration of Issues

- a. As regards banks as sponsor may not need to maintain the liquid net worth on a continuous basis but will have to ensure that the AMC maintains the minimum net worth on a continuous basis and sponsor would be required to infuse capital only if the net worth of the AMC falls below the mandated threshold.
- b. The net worth of the sponsor in preceding 5 years need not be in liquid form and the existing requirement of positive net worth in immediately preceding 5 years may continue but the sponsor should ensure that the

positive liquid net worth is more than the proposed capital contribution of the sponsor in the asset management company.

- c. The sponsor has the obligation to infuse capital in the AMC during any exigency, hence needs the capital in hand to capitalize the AMC when required. But there is no obligation for the AMC like the sponsor to capitalize any entity. Therefore, the requirement of positive liquid net worth may be applicable on the sponsor only.
- d. However, even in case of AMC, as they are required to meet ongoing expenses, the minimum net worth should be deployed in a manner such that it is available to be utilized when required. It is thus proposed to prescribe that net worth of the AMC may be deployed either in liquid assets or additionally in listed AAA rated debt securities without bespoke structures/structured obligations, credit enhancements or embedded options or any other structure /feature which increase the liquidity risk of the instrument.

D. Proposal

- a. The existing eligibility requirements of sponsor mentioned in Section 4.1 A(a) & Section 4.1 A(b) may remain unchanged.
- b. Based on the aforesaid consideration of issue at section 4.1(C), the eligibility criteria for a sponsor w.r.t sound track record under the existing Regulation 7 of MF Regulations may be modified as under:

The sponsor should

- i. ensure that the positive liquid net worth is more than the proposed capital contribution of the sponsor in the asset management company and ensure that in case of change in control of the existing asset management company due to acquisition of shares, it should be able to demonstrate the firm commitment (by way of having positive liquid net worth or tying up of funds) to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher. and
- ii. The sponsor should have

- (i) Net profit after providing for depreciation, interest and tax in each of the immediately preceding five years; and
- (ii) Average net annual profit after providing for depreciation, interest and tax during the immediately preceding five years be at least INR 10 cr.
- iii. The provisions of liquid net worth may be applicable on the sponsors;
- iv. AMCs may deploy the minimum prescribed liquid net worth either in liquid assets or in listed AAA rated debt securities without bespoke structures/structured obligations, credit enhancements or embedded options or any other structure /feature which increase the liquidity risk of the instrument.
- v. The cost of acquisition may be funded out of borrowings by a sponsor but he should have sufficient assets to encumber for borrowings other than shares of proposed AMC.
- vi. Further, the sponsor stake in the AMC should be free from any encumbrance at all times. It is felt that any situation of invocation of pledged shares of an AMC of a mutual fund alongside having negative repercussions on the reputation of the concerned mutual fund may have the possibility of having a ripple effect on other mutual funds and the mutual fund industry in general and should be avoided as a matter of utmost caution. Keeping in mind the above and the fact that mutual funds largely manage funds of retail investors, it is proposed that encumbrance of shares of Sponsors in the AMCs shall be explicitly disallowed.
- vii. The sponsor shall be responsible to ensure that AMC is in compliance with maintaining minimum net worth.

4.2. Alternate Eligibility Criteria for Sponsor

A. Suggestion in the Consultation Paper

- a. An alternate eligibility criteria for sponsors may be enabled basis what the sponsor can contribute to the mutual fund business in order to

ensure that the sponsor contributes sufficiently to the mutual fund business in terms of funding, providing infrastructure, mobilizing human capital, imbibing global best practices etc.

- b.** In view of the above, the following were proposed as alternate eligibility criteria for sponsor of MF :-
 - i.** Capitalization of AMC: Considering that the track record of the sponsor as mentioned in the existing route is not being considered for alternate eligibility route and the average expense of the recently incorporated AMCs is approximately around INR 10 cr. per year, INR 150 cr. may be a reasonable requirement for the capitalization of a new AMC by a sponsor as it will create sufficient entry barriers and at the same time is not too steep for any serious applicant. In view of the above, the proposed Sponsor may adequately capitalize the AMC such that the positive liquid net worth of AMC is not less than INR 150 cr.
 - ii.** The AMC may be required to have a positive liquid net worth of not less than rupees one hundred crore and the AMC may maintain such net worth till it has profits for five consecutive years. The minimum positive liquid net worth requirement may be required to be maintained by the AMC on a continuous basis.
 - iii.** The sponsor may be responsible to ensure that AMC is in compliance with maintaining minimum positive liquid net worth.
 - iv.** The capital contributed to the AMC to the extent of minimum required (i.e. up to INR 150 cr.) may be locked-in for a period of 5 years. Further, the minimum sponsor stake of 40% may also be locked in within the same period of 5 years.
 - v.** The Sponsor may appoint sufficiently experienced personnel in AMC such that the total experience of Chief Executive Officer, Chief Operating Officer, Chief Regulatory Officer, Chief Compliance Officer and Chief Investment Officer combined should be at least 30 years.
 - vi.** In case acquisition of existing AMC, the proposed sponsor may meet the requirement of adequate capitalization of AMC and the sponsor

may have minimum positive liquid net worth equal to incremental capitalization required to ensure minimum AMC capitalization and should be able to demonstrate the firm commitment (by way of positive liquid net worth or tying up of funds) to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher.

vii. Fit and Proper Requirements to be fulfilled.

B. Public Comments

The main comments received are summarized below:

- a. Expenses of the recently incorporated AMCs may be higher than INR 10cr.
- b. Clarity has been sought regarding (i) whether the parent entity of the sponsor or the sponsor Group can act as a sponsor (ii) inter-se shareholding changes within the sponsor/group companies be allowed within the lock in period of 5 year and (iii) whether only the sponsor contributions which results in the net worth of AMC being INR 150 cr. should be locked in for 5 years or the entire contribution of the sponsor in the AMC (if applicable).
- c. The combined experience of personnel appointed by the sponsor should be increased slab wise depending on the age of the AMC as well as the AUM managed by the AMC. Older AMCs managing higher AUMs should have more experienced resources in the top management. The term Chief Regulatory officer may be defined.

C. Consideration of Issues

- a. The average expenses of the recently incorporated AMCs have been examined and is a representative number for the mutual fund industry. Individual AMCs may spend more as per specific strategies/ requirement.
- b. The sponsor of an AMC shall be a specified entity (ies), which may belong to a group and be joint or co- sponsors. However, inter se

transfer between Group companies of sponsor within the lock in period may be permitted provided all the eligibility conditions and requirements of sponsor of a mutual fund is being fulfilled by the specified entity (ies).

- c. In case of acquisition of stake by a sponsor in an existing AMC through the alternate route, the shareholding equivalent to INR 150 cr. shall be locked in for 5 years.
- d. The proposed alternate eligibility criteria is applicable for new entities who want to sponsor a MF. Therefore, defining contribution of sponsor regarding human capital basis age of the AMC and AUM managed may not be relevant. The experienced personnel to be appointed by the sponsor shall include Chief Risk Officer, not a Chief Regulatory Officer.

D. Proposal

- a. Under the alternate eligibility criteria, the following may be mandated for the sponsor.
 - i. The Sponsor should adequately capitalize the AMC so that the net worth of AMC is not less than INR 150 cr.
 - ii. The AMC shall be required to have a net worth of not less than rupees one hundred crore and the AMC shall maintain such net worth till it has profits for five consecutive years. The minimum net worth requirement shall be maintained by the AMC on a continuous basis.
 - iii. The sponsor shall be responsible to ensure that AMC is in compliance with maintaining minimum net worth.
 - iv. The initial shareholding representing capital contributed to the AMC to the extent of minimum required (i.e. up to INR 150 cr.) should be locked-in for a period of 5 years. Further, the minimum sponsor stake of 40% shall also be locked in for the same period of 5 years.
 - v. The Sponsor should appoint sufficiently experienced personnel in AMC such that the total combined experience of Chief Executive Officer, Chief Operating Officer, Chief Risk Officer, Chief Compliance Officer and Chief Investment Officer should be at least 30 years.

- vi. In case of acquisition of existing AMC, the proposed sponsor should meet the requirement of adequate capitalization of AMC and the sponsor should have minimum positive liquid net worth equal to incremental capitalization required to ensure minimum AMC capitalization. The sponsor should be able to demonstrate the firm commitment (by way of positive liquid net worth or tying up of funds) to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher.
- vii. In case of acquisition of stake by a sponsor in an existing AMC through the alternate route, the shareholding equivalent to INR 150 cr. shall be locked in for 5 years.
- viii. The applicant should be a fit and proper person.
- ix. The cost of acquisition may be funded out of borrowings by a sponsor but he should have sufficient other assets to encumber for borrowings other than the shares of the proposed AMC.
- x. Minimum incremental capital contribution required in the AMC shall not be funded through borrowings and shall be funded only out of the net worth of the acquirer.
- xi. Sponsor stake should be free from encumbrances in any form at all points of time.

4.3. Eligibility norms of Private Equity Funds/ Pooled Investment Vehicles/ Pooled Investment Funds (PE) to be Sponsor

A. Suggestion in the Consultation Paper

a. Permitting PEs to sponsor Mutual Funds

- i. PE with significant capital may invest in technology, bring in strategic guidance and good talent to fuel growth and innovation and expand the presence of mutual funds including driving inclusive growth. PE may also provide constructive competition to the current entities in the Mutual Fund industry and improve value to investors. In the recent past, PE have been indirectly holding stake in sponsor of

mutual funds. Also, as per some inputs, sponsors looking for exit from the mutual fund business have not been able to find good offers from entities other than PEs.

- ii. In view of the above, PEs may be allowed to sponsor a mutual fund through the alternate route meeting all the requirements prescribed therein to qualify as sponsor of a mutual fund. In addition, additional criteria/ safeguards may also be made applicable to PEs to qualify as mutual fund sponsor.

b. Additional criteria for PEs to qualify as mutual fund sponsor

- i. The applicant PE (scheme/ fund) may itself be a body corporate or, a body corporate set up by the PE may set up a mutual fund. The applicant body corporate may be set up in India or abroad.
- ii. PE or its manager may have a minimum of five years of experience in the capacity of fund/investment manager and the experience of investing in the financial sector. It may have managed committed and drawn-down capital of not less than INR 5,000 cr. as on the date of the application.
- iii. Presently, MF schemes have restrictions w.r.t. investments in associate or group company of the sponsor. In case of a Sponsor owned /majority owned by a PE, the definition of “Associate” or “Group Company” may, in addition to the existing requirements, also include any of the following:
 - “Associate” or “Group Company” of the Manager of the sponsor PE
 - Investee Companies in which the shareholding held by the Schemes/ Funds managed by Manager of the proposed sponsor PE is 10% or more
 - Any investee company in which sponsor PE has more than 10% Investment or the Directors of sponsor PE/ corporate sponsor has Board representation.

c. Additional safeguards for PEs acting as mutual fund sponsor

- i. No off-market transactions may be permitted between the schemes of MF and

 - Sponsor PE; or
 - Schemes/ Funds managed by the manager of the sponsor PE; or
 - Investee Companies of schemes/ funds of sponsor PE where it holds more than 10% stake; or has a board representation.
- ii. The Mutual Fund sponsored by the PE may not participate as an anchor investor in the public issue of an investee company, where any of the schemes/ funds managed by the sponsor PE have an investment of 10% or more or has a board representation.
- iii. The lock-in period of 5 years for minimum sponsor stake proposed under the alternate eligibility route may be reasonable for PE as well. Further, the condition that lock in period can continue in case of transfer to any other entity/ SPV within the PE group may be allowed (similar to the one provided in SEBI (ICDR) Regulations, 2018) considering the relatively short life of PE. The said lock in period of 5 years may also be applicable to the shareholding of PE in the corporate entity/ SPV which is sponsoring the Mutual Fund, as the case may be.
- iv. The capital market license obtained by the Investment Manager in its country or registration may be considered to be sufficient when considered in addition to the existing qualifying conditions (under alternate eligibility criteria as proposed) and no other registration/ licensing requirement may apply.

B. Public Comments

The main comments received are summarized below:

- a. Sponsor should be the manager / permanent entity within the PE group and not a scheme / fund. Scheme / fund as it will have a limited life which may not be appropriate for the long term.

- b.** The finalized Regulations must clearly distinguish between PE vehicle, which is directly applying as a sponsor and cases where PEs' hold controlling interest in an operating entity eligible to, and applying to be a sponsor. The extension of the definitions of 'Associate Company' and 'Group Company' and the lock in period of 5 years should not apply if the Indian entity which proposes to be a sponsor is held majorly by a PE provided the Indian entity satisfies all the main eligibility requirements.
- c.** PE or its manager may have minimum 8 to 10 years of experience instead of 5 years. The criteria relating to committed and draw-down capital of at least INR 5000 cr. may be applicable to all private equity funds and/or managers in the private equity group and not only to the private equity fund / manager of the private equity fund.
- d.** The definition of associate or group should not include portfolio companies of the PE fund simply because the sponsor has board representation. As part of their investments, PE funds typically have board representation even in minority stakes (including stakes as low as 10%), and this definition would be very onerous for most PE funds, which have multiple investments with board seats, but do not otherwise have significant influence in the management and operations of those companies.
- e.** To re-visit the applicability of Regulation 7B for private equity funds, with the appropriate safeguards already in place.
- f.** One of the additional safeguards mentioned is the entity should be undertaking investment management business with a capital markets license. This may not always be necessary and may depend on the relevant jurisdiction. Therefore, as long as investment management activities are being undertaken in accordance with relevant laws of that jurisdiction, it should suffice to meet the criteria.

C. Consideration of Issues

- a.** The applicant PE (scheme/ fund) shall itself be a body corporate or, a body corporate set up by the PE shall set up a mutual fund. Therefore, although the scheme/ fund may have limited life, but the body corporate shall be established as a going concern.
- b.** PEs may only sponsor a mutual fund through the alternate eligibility criteria route. If any Indian entity is majorly held by any PE and that entity in turn is eligible to be a sponsor even through the main eligibility route, the safeguards applicable on the PE shall not be applicable.
- c.** Having a threshold for the minimum amount managed by a PE, the time period it has been in existence, experience of investing in financial sector would give confidence in the ability of the sponsor to set up a MF and manage the MF business. Further, the drawn down capital requirement of INR 5000cr. has been arrived at by the analysis of the information sought from top 20 AIFs, where average investment made under a scheme by them amounts to be INR 4969 cr., which is comparable to the proposed requirement of INR 5000 cr. Therefore, the criterion of having managed a drawdown or commitment of INR 5000cr. is proposed to be applicable for entity intending to act as sponsor of the MF and hence, the requirement for the drawn down capital shall be applicable for the manager of the scheme/ fund of the PE applying for the sponsorship; and ancillary schemes of the PE group may not be added to demonstrate equivalence with the threshold value.
- d.** In order to address the sponsor related conflicts that have been laid out in the consultation paper it has been proposed that influence of sponsor over the functioning of Mutual Funds directly or indirectly be recognized and minimized wherever practically possible. Towards this end, it is necessary to recognize the investee companies where the sponsor PE holds sway either through shareholding or indirectly by way of Board representation or any other means.
- e.** Regulation 7B shall also be applicable to PEs which apply for sponsor of a MF.

- f. Capital market license is the proxy through which it can be ascertained that investment management activities are being undertaken in accordance with relevant laws of a jurisdiction and in absence of building in such a requirement, it would be practically very difficult to ascertain the same.

D. Proposal

- a. PEs may be allowed to sponsor a mutual fund through the alternate route meeting all the requirements as prescribed at paragraph 4.2(D) above to qualify as sponsor of a mutual fund.
- b. In addition, following criteria/ safeguards may also be made applicable to PEs to qualify as mutual fund sponsor.
 - i. The applicant PE (scheme/ fund) may itself be a body corporate or, a body corporate set up by the PE may set up a mutual fund. The applicant body corporate may be set up in India or abroad.
 - ii. PE or its manager may have a minimum of five years of experience in the capacity of fund/investment manager and the experience of investing in the financial sector. It may have managed committed and drawn-down capital of not less than INR 5,000 cr. as on the date of the application.
 - iii. The current restrictions for MF schemes w.r.t. investments in associate or group company of the sponsor may also be applicable for a Sponsor owned /majority owned by a PE. In this regard, the definition of “Associate” or “Group Company” may, in addition to the existing requirements, also include any of the following:
 - “Associate” or “Group Company” of the Manager of the sponsor PE.
 - Investee Companies in which the shareholding held by the Schemes/ Funds managed by Manager of the proposed sponsor PE is 10% or more.
 - Any investee company in which sponsor PE has more than 10% Investment or the Directors of sponsor PE/ corporate sponsor

has Board representation or right to nominate Board representation.

- c.** The following additional safeguards may also be applicable for PEs acting as mutual fund sponsor.
 - i.** No off-market transactions may be permitted between the schemes of MF and
 - Sponsor PE; or
 - Schemes/ Funds managed by the manager of the sponsor PE; or
 - Investee Companies of schemes/ funds of sponsor PE where it holds more than 10% stake; or has a board representation or right to nominate Board representation.
- d.** The lock-in period of 5 years for minimum sponsor stake proposed under the alternate eligibility route may be reasonable for PE as well. Further, the condition that lock in period can continue in case of transfer to any other entity/ SPV within the PE group may be allowed (similar to the one provided in SEBI (ICDR) Regulations, 2018) considering the relatively short life of PE provided all the criteria required for the PE to act as sponsor are met by the transferee PE as well. The said lock in period of 5 years may also be applicable to the shareholding of PE in the corporate entity/ SPV which is sponsoring the Mutual Fund, as the case may be.
- e.** Through the capital market license, it may be ascertained that the applicant PE has enough experience, track record and eligibility regarding the fit and proper requirement. As an additional due-diligence, currently comments of foreign Regulators are sought by SEBI of the (i) sponsoring entity and (ii) the group/associate entities of the sponsor if the person in control (direct or indirect) of group/associate entity is also person in control in the sponsoring entity.

4.4.Reduction of stake and disassociation of sponsor - Mandatory and Voluntary

The 3 decades of regulatory evolution of MF industry have seen a gradual but significant shift in the nature of role and responsibility of sponsor versus the AMC. Now, AMCs are prepared enough to stand on their own gradually and create trust among investors. Considering this there may be a need to seek wider consultation on the issue, proposals on Voluntary and Mandatory reduction in stake of sponsor in AMC were made in the Consultation paper.

A. Suggestion in the Consultation Paper

The following requirements to be applicable in case the Sponsor voluntarily or mandatorily disassociates from the AMC:

- a.** The disassociating sponsor shall reduce its shareholding in asset management company and trustee company below the specified threshold (public comments were sought on 10% or 26% as the threshold).
- b.** The disassociating sponsor may be considered as “Financial investor” and no obligation of sponsor will apply to the disassociating sponsor after disassociation.
- c.** The shareholding of AMC (held by the disassociating Sponsor or any other shareholders) may be freely exchanged with other Investors without any restrictions/ prior approval.
- d.** The requirement of Regulation 7B (2) of MF Regulation shall continue to apply, which states:

Any shareholder holding 10% or more of the share-holding or voting rights in the asset management company or the trustee company of a mutual fund, shall not have, directly or indirectly,

(a) 10% or more of the share-holding or voting rights in the asset management company or the trustee company of any other mutual fund; or

(b) representation on the board of the asset management company or the trustee company of any other mutual fund.

However, in addition to above, following is also suggested as a part of consultation paper w.r.t mandatory and voluntary disassociation.

- a. An exit option to the unitholders of the existing schemes of the concerned Mutual Fund, without any exit load may be provided in case of voluntary reduction in sponsor's stake while no exit option to the unitholders of the existing schemes of the concerned Mutual Fund may be provided subject to suitable disclosure about the transition at least 30 days in advance in case of mandatory reduction in sponsor's stake.
- b. Obligation regarding inappropriate valuation under Regulation 25(20) may continue to be borne by the disassociating Sponsor even after disassociation in case of voluntary disassociation while it may continue to be borne by the disassociating Sponsor up to the period ending on the date of disassociation in case of mandatory disassociation.

In case of voluntary disassociation, obligation already incurred for Guaranteed returns schemes under Regulation 38 may continue to be borne by the disassociating Sponsor till the existence of such scheme. On the other hand, in case of mandatory disassociation, it may cease to apply to the disassociating sponsor after following due process as may be specified by SEBI.

B. Public Comments

- a. The conflicts associated with sponsors may be addressed with appropriate regulations, continuous monitoring and appropriate governance structures, rather than making Sponsors exit from AMCs.
- b. A sponsor brings funding to the AMC along with name, reputation, expertise, institutional values, positive direction, corporate governance, guidance and support for the Mutual Fund. In difficult

times, the Sponsor may provide solid backing / support to sustain the AMC / Mutual Fund's operations for the benefit of the unitholders. Further, sponsor's stake also evidences "skin in the game".

- i. Better health of the AMC would trigger the exit of the Sponsor - this would disincentivise entities from sponsoring mutual funds.
- ii. Sponsors have a limited role to play during critical times/events. Through reduction of stake of sponsor, conflicts will be avoided and the independence of decision making at AMC level will be strengthened.
- iii. Mixed responses have been received in the media articles regarding the mode of reduction of sponsor stake in the AMCs. With the intention to usher in a new era of self-sufficient AMCs, media suggested mandatory reduction in the stake of sponsor. But it has also suggested that a more practical and consist model is to allow sponsors to disassociate themselves voluntarily after a period of maturity of MF/AMC, without mandating a disinvestment. Mandatory reduction provides a definite glide path to all concerned stakeholders, including unitholders, to avoid uncertainties.
- iv. Reduction should be voluntary and left to the market forces and there should be no mandatory dilution. There could be regulatory guidance via circulars to prevent any pitfalls observed. The current structure & constitution of MFs in India provides a well governed transparent system that ensures that unitholders interests are well protected; also since the Sponsor ensures capital & networth requirements to build scale it may be prudent to let the Sponsor decide on the stake sale/ timeline, based on specific outlook / business fitment that each Sponsor may envisage at various stages of group evolution.
- v. Fair price discovery is possible through voluntary reduction.
- vi. Prospective amendments to the Regulations may lay down the process with respect to the application for disassociation, as well as set out the application form/checklist format. Further, it may be

better for the disassociating entity to make the application, since the process will then be driven and undertaken by the entity doing the transactions itself and not any other entity.

- vii. Mandatory reduction in stake may be detrimental to the AMC business and Sponsors may lose interest in the AMC business. There is no motivation for a real long term committed player to enter the space if he knows he has to exit certainly after some time.

C. Consideration of Issues

- a. Some respondents have commented not in favour of reduction of stake largely with the view that in such case there would not be any long term committed player to enter in to the mutual funds space and it may not be appropriate for the long term growth of the industry. However, for mature AMCs, the institutional values, corporate governance, reputation etc. would have been built over the period of time at the AMC level itself and the same would sustain even if the sponsor were to reduce its influence. Also, the rationale given regarding significance of the role of sponsor is not acceptable in such AMCs and also in the context of regulatory evolution as explained in the earlier section.
- b. Large number of comments are in favour of voluntary reduction of stake of the sponsor. Further, it is also acknowledged that the brand of a mutual fund gets built over a period of time because of the reputation of the Sponsor and mandatory dissociation of the Sponsor may have a significant impact on the same. It may thus be prudent at this stage to give an option to the sponsors of eligible AMCs to disassociate and review the requirement after a reasonable time frame.
- c. Appropriate guidelines may be issued regarding the process of voluntary reduction of stake of the sponsor in the AMC through the MF Regulation and circulars issued thereunder.

D. Proposal

- a. Proposal for voluntary reduction in stake of sponsor may be accepted.
- b. Appropriate guidelines may be issued regarding the voluntary reduction of stake of the sponsor from the AMC through the MF Regulation and circulars issued thereunder.

4.5. Norms for acting as Self- Sponsored AMC

A. Suggestion in the Consultation Paper

- a. The primary principle for permitting disassociation of existing sponsors is that AMC is able to meet all the sponsor-related eligibility requirements itself. The qualifying conditions for becoming a Self-Sponsored AMC may be as under:
 - i. The AMC may be carrying on business in financial services for a period of not less than five years;
 - ii. The AMC may have positive liquid net worth in all the immediately preceding five years;
 - iii. Net profit after providing for depreciation, interest and tax in each of the immediately preceding five years and average net annual profit after providing for depreciation, interest and tax during the immediately preceding five years may be at least INR 10 cr.
 - iv. Sponsor(s) proposing to disassociate may have been a Sponsor(s) of the concerned mutual fund for at least 5 years before the proposed date of disassociation;
 - v. Sponsor(s) proposing to disassociate may undertake to reduce shareholding below specified threshold within a specified time from the proposed date of disassociation;
 - vi. The shareholding proposed to be reduced by the Sponsor(s) may not be under any encumbrance or lock-in.

- vii. Sponsor(s) proposing to disassociate itself may undertake to honour all the obligations applicable to it under Regulation 38 of MF Regulations (Guaranteed Returns) as on proposed date of disassociation as applicable.
- viii. AMC proposing to become a Self-Sponsored AMC may undertake to not launch any new Guaranteed Returns scheme under Regulation 38 of MF Regulations and not accept any new subscriptions in existing Guaranteed Returns schemes under Regulation 38 of MF Regulations.
- ix. Public comment was sought regarding any other eligibility condition/ safeguards that may be cast up on an AMC to become self - sponsored.

B. Public Comments

- a. A standalone AMC will not be able to sustain itself as it needs an entire ecosystem (distribution support, brand, tech and other areas) to support and be successful.
- b. The term 'liquid net worth' may be replaced with net worth. Otherwise, the term liquid investments may include investment in debt mutual fund schemes, excluding seed capital portion.
- c. To become a self- sponsored AMC, the positive net worth in all the immediately preceding five years should be at least INR 500 cr., excluding the seed capital investment in the mutual fund schemes. The higher threshold would ensure that only strong and mature AMCs qualify for becoming self-sponsored AMCs in the interest of the unitholders. Also, there may be a generic clause which states that Sponsors proposing to disassociate itself will have to honor all the obligations applicable to it on the proposed date of disassociation as applicable
- d. The market is not aware of existence of self-sponsored AMCs anywhere else.

- e. No shareholder should have disproportionate rights to appoint a director. For example, any shareholder holding 10% or more will have a right to appoint one director for shareholding of 10% or multiple thereof.

C. Consideration of Issues.

- a. For mature AMCs, the necessary ecosystem (distribution support, brand, tech and other areas) would have been built over the period of time and the AMC may sustain even if the sponsor were to reduce its influence.
- b. The premise of self-sponsored AMC has been decided based on the expertise and financial wherewithal that is expected from a sponsor to bring in during inception of a new AMC. Accordingly, the requirement for being eligible to become a self-sponsored AMC has been proposed assuming that the AMC by itself can meet the eligibility condition of the sponsor.
- c. As there is no obligation for the AMC like the sponsor to capitalize any entity, the requirement of positive liquid net worth may not be posed to the AMC to become self-sponsored. However, the minimum net worth of the AMC may be deployed either in liquid assets or additionally in listed AAA rated debt securities without bespoke structures/structured obligations, credit enhancements or embedded options or any other structure /feature which increase the liquidity risk of the instrument.
- d. The preliminary thought under consideration for an AMC to become self-sponsored is to meet all the sponsor-related eligibility requirements itself. In the current scenario, the sponsors, willing to set up an AMC, require to have positive net worth in all the immediately preceding five years. Therefore, AMCs may not be required to hold minimum net worth of INR 500 cr. in all the preceding 5 years.
- e. In the current Regulatory framework there is no specific obligations cast up on the sponsors other than Regulation 38 of MF Regulations regarding Guaranteed Returns schemes and Regulation 25(20) to

compensate the affected investors and/or the scheme for any unfair treatment to any investor as a result of inappropriate valuation. While the outgoing sponsor may still continue to fulfill its obligations towards the Guaranteed Return schemes till the existence of such scheme, the obligation w.r.t. Regulation 25(20) regarding compensation to the affected investors may not be cast to the outgoing sponsor after the disassociation is completed. Post disassociation, the obligation under Regulation 25(20) shall be met by the self-sponsored AMC itself.

D. Proposal

- a.** The qualifying conditions for becoming a Self-Sponsored AMC may be as under:
 - i.** The AMC may be carrying on business in financial services for a period of not less than five years;
 - ii.** The AMC may have positive net worth in all the immediately preceding five years;
 - iii.** Net profit after providing for depreciation, interest and tax in each of the immediately preceding five years and average net annual profit after providing for depreciation, interest and tax during the immediately preceding five years may be at least INR 10 cr.
 - iv.** Sponsor(s) proposing to disassociate may have been a Sponsor(s) of the concerned mutual fund for at least 5 years before the proposed date of disassociation;
 - v.** Sponsor(s) proposing to disassociate may undertake to reduce shareholding below specified threshold within a specified time from the proposed date of disassociation;
 - vi.** The shareholding proposed to be reduced by the Sponsor(s) may not be under any encumbrance or lock-in.
 - vii.** Sponsor(s) proposing to disassociate itself may undertake to honour all the obligations applicable to it under Regulation 38 of MF

Regulations (Guaranteed Returns) as on proposed date of disassociation as applicable.

- viii. AMC proposing to become a Self-Sponsored AMC may undertake to not launch any new Guaranteed Returns scheme under Regulation 38 of MF Regulations and not accept any new subscriptions in existing Guaranteed Returns schemes under Regulation 38 of MF Regulations.
- ix. AMC shall maintain the minimum net worth requirement on a continuous basis.

4.6. Re-Association of the Sponsor(s):

A. Suggestion in the Consultation Paper

A disassociated sponsor and/or any new entity may become sponsor(s) of the Mutual Fund subject to the following:

- a. AMC fails to meet the criteria of Self-Sponsored AMC
- b. The proposed sponsor(s) meet all the requirements and obligations specified in MF Regulations pertaining to the Sponsors.
- c. The proposed sponsor(s) follows due process of obtaining approval as 'Sponsors'. An exit option is provided to the unitholders of the existing schemes of the concerned Mutual Fund, without any exit load.

B. Public Comments

- a. In case of a self-sponsored AMC falling foul of the criteria for self-sponsoring,
 - i. Some cure period (for example, one year) may be provided. At this stage, if any existing shareholder meets the sponsorship criteria, then they may be deemed to be a sponsor, subject to obtaining of approval (which would have to be applied for within a specified period - say, 3 months). If there is no existing

shareholder meeting the criteria and no firm commitment from the AMC with respect to any incoming shareholder, then the AMC can be acted against in terms of Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

- ii. AMC should be disallowed from launching any new scheme, until the 'specified conditions for Self -Sponsored AMC are met.
- iii. AMC Board may be given a period of one year to ensure compliance with the conditions.
- iv. AMC may not be allowed to declare any dividend, till the specified conditions for "Self Sponsored AMC' are fulfilled.
- v. Continuously monitoring whether the AMC fall within the specified thresholds for Self-Sponsored AMC is highly undesirable. In fluctuating markets, this can create unwarranted uncertainty leading to not only added compliance burdens but also requiring AMCs to constantly seek opposite goals of sponsorship and disassociation.

C. Consideration of Issues

- a. Statutory auditor may be mandated to submit yearly compliance report on the fulfilment of eligibility criteria by the self sponsored AMC based on audited financial statement of AMC within a specified period from the end of the financial year. Further the trustees and board of AMC shall provide a compliance status to SEBI in the half yearly and quarterly compliance reports furnished by them respectively.
- b. A cure period of one year may be provided to AMC failing to meet the eligibility condition of Self-Sponsored AMC. Until specified conditions for Self -Sponsored AMC are met, AMC will be disallowed to launch any new scheme, declare any dividend. Detailed procedure may be laid down to protect the interests of

unitholders in case the AMC is not able to retain the status of self-sponsored AMC or re-associate a sponsor within a reasonable time.

D. Proposal

- a. A disassociated sponsor and/or any new entity may become sponsor(s) of the Mutual Fund subject to the following:
 - i. AMC fails to meet the criteria of Self-Sponsored AMC.
 - ii. The proposed sponsor(s) meet all the requirements and obligations specified in MF Regulations pertaining to the Sponsors.
 - iii. The proposed sponsor(s) follows due process of obtaining approval as 'Sponsors'. An exit option is provided to the unitholders of the existing schemes of the concerned Mutual Fund, without any exit load.
- b. Statutory auditor may be mandated to submit yearly compliance report on the fulfilment of eligibility criteria by the self sponsored AMC. Further the trustees and board of AMC shall provide a compliance status to SEBI in the half yearly and quarterly compliance reports furnished by them respectively.
- c. A cure period of one year may be provided to AMC failing to meet the eligibility condition of Self-Sponsored AMC.

4.7.Upper and lower limits for shareholding by investors in an AMC after disassociation of the Sponsor

A. Suggestion in the Consultation Paper

- a. After disassociation of the sponsor from the AMC, there would only be "Financial Investors" in the AMC. The shareholders in the AMC may be treated as the financial investors. The disassociating sponsor may also be considered as "Financial investor."

- b. Appropriate upper and lower limits of shareholding in the AMC may be put up on in order to ensure that mutual fund is not controlled by select few investors but at the same time mutual fund ownership should not be too fragmented.
- c. Accordingly, and upper limit of (26% or 10%) and lower limit (5%) for shareholding by the Investors in an AMC may be considered after disassociation of the Sponsor.

B. Public Comments

- a. As per one of the media articles, reduction in sponsor's stake will pave way for other significant shareholders, bringing in strategic guidance, inclusivity, and talent to fuel growth and innovation and with the presence of other investors in the AMC, MFs will work in the interest of investors by engaging in fewer related party transactions and minimize investment in instruments connected to the sponsor, its associate, or group companies.
- b. The upper limit of shareholding after disassociation of the Sponsor should be capped at 10% and lower limit should be 5% to avoid major conflicts by divesting control of a single shareholder and at the same time ensuring unfragmented decision making, sufficient accountability and responsibility with the AMC.
- c. The upper limit of 26% is prudent however lower limit needs to be defined based on private limited or listed company. Lower limit should be based on sponsor requirements.
- d. A limit of 10% will be quite low, particularly for unlisted AMCs. Keeping a low threshold may be a disincentive to take the responsibilities of a Sponsor including reluctance to share brand names, higher risk of conflict amongst shareholders, low interest in sharing of expertise etc. Under the Companies Act, special resolutions are to be approved by at least 3/4th majority. If the Sponsor is having 10% stake, other shareholders may make major changes whereas the responsibility under the Regulations lies with the Sponsor. A limit of

26% may also enable better management of AMC. Any other shareholder, other than the Sponsor, may hold below the 26% limit.

- e. It is difficult to prescribe a threshold in such cases, since the definition of "control" in the Regulations already set out a 10% threshold. If the same is adopted for this purpose without any modification, it would not act as a strong-enough incentive to reduce the sponsor's stake (which may be required to achieve the goal of reduced sponsor-related conflicts).
- f. Prescribing a lower limit (5% or otherwise) may not be required due to the following reasons.
 - i. The so-called fragmented shareholding of the AMC may not have any adverse effects since AMCs are required to be professionally managed and its obligations (whether it is sponsored or self-sponsored) are attracted on a standalone basis.
 - ii. Since the entity would be classified as financial investor, who can freely exit without any restrictions.
 - iii. As per one of the media articles, the assumption that fragmented shareholding by itself is a good thing is questionable, as seen in many banks. The regulator should let a thousand flowers bloom from a control perspective so long as it is without diluting accountability standards. Also, bringing in players from different backgrounds will make the industry more heterogeneous.

C. Consideration of Issues

- a. Post disassociation of the sponsor, if the maximum shareholding of any shareholder in the AMC including the sponsor is capped at 26%, it can still influence any decision according to its own interest through exercising negative control, as special resolutions are to be approved by at least 3/4th majority of shareholders. Capping maximum shareholding of any shareholder in the AMC including the sponsor at

less than 10% may avoid any undue influence of any shareholder in the AMC because as per the MF Regulations, control is any direct or indirect ownership, control or holding shares carrying not less than 10% of the voting rights. At the same time. it cannot exercise any negative control in any resolution of the AMC also. Therefore, the maximum shareholding of any shareholder including the sponsor post disassociation may be capped at 10%.

- b. Post disassociation of the sponsor from the AMC, all the shareholders of the AMC may be called the “Financial Investors”.

D. Proposal

- a. Post disassociation, the upper limit of shareholding for any Financial Investor may be capped at 10%. The sponsor may thus be allowed to completely extinguish its shareholding from the AMC post desponsorisation.

4.8. Time Period for reduction in sponsor’s stake in AMC.

A. Suggestion in the Consultation Paper

Public comment was sought regarding the specified time period post which sponsor may reduce its shareholding in the AMC.

B. Public Comments

- a. Some comments expressed that the timeline for offloading stakes in listed space may be allowed between 9 to 12 months preventing the factors like changes in economic/market conditions, stakeholders, board of directors, management etc. which may adversely affect the disassociation process if longer period is considered. While others proposed to keep it within 3 - 5 years. A period of three years can be prescribed for facilitating a graded exit.
- b. In case of Banks which are sponsor of mutual funds, banking regulations permit holdings above 50% or below 30% only.

C. Consideration of Issues

- a. Considering that voluntary reduction of stake may be permitted to the sponsor, a time period of 3- 5 years may be sufficient for the sponsor of a listed AMC while a reduced period of 2-3 years may be permitted for a sponsor of unlisted AMC to disassociate itself from the AMC. During the aforesaid time period when the Sponsor stake may be less than 40% but still not reduced to below 10 % required for dissociation, all the obligations of the Sponsor shall continue to apply on the outgoing Sponsor.

D. Proposal

- a. Listed AMC's sponsor may disassociate itself within a time period of 3-5 years while a reduced period of 2-3 years may be allowed for unlisted AMC. In the meantime, the obligations of Sponsor shall continue to apply on the outgoing Sponsor.
- b. The sponsor may be required to commit to a graded stepwise reduction over this time period in a manner specified by SEBI.

4.9. Control over AMC and MF operations by disassociated sponsor/ financial investor and its impact.

A. Suggestion in the Consultation Paper

- a. Even after disassociation of the sponsor from the AMC, there might be continuous influence of the sponsor over the AMC leading to various conflicts. In order to ensure that mutual fund business is conducted independently and professionally,
 - i. Shareholding of all shareholders (including that of the disassociated sponsor) may be reduced in the AMC and Trustee Company to below a specified threshold so that the control exercised by any shareholder is not substantial.
 - ii. Besides shareholding and voting rights, control may also be exercised through nomination of directors to the Board of AMC. As

per Section 160 of Companies Act, any share holder may propose a director to the Board of a company. However, to limit the undue influence of disassociated sponsor/ financial investor, the aforesaid right of any shareholder of the AMC or any person associated with shareholders (such as employees, relatives, etc.) may be restricted.

iii. In case it is observed that any shareholder directly/ indirectly controls/ influences the operations of a mutual fund in such a way which adversely impacts the unitholders, SEBI may initiate suitable enforcement action against such shareholder.

b. Presently, Sponsor's shareholding in AMC and Trustee Company are mirror image of each other. Any difference in shareholding pattern of AMC and Trustee Company due to Sponsor mandatorily/ voluntarily disassociating itself may create different types of conflicts and may not be in the interest of the unitholders. Thus, the change of shareholding of AMC may mandatorily require change of shareholding of Trustee Company so as to ensure that shareholding of Trustee Company continues to remain a mirror image of the shareholding of AMC at all times.

c. The trust deed of mutual fund trust is signed by Sponsor (Settlor) and Trustee Company/ Individual Trustees and is in the form of a contract. As per the applicable provisions of Contract Act, any amendment to trust deed of a mutual fund would require concurrence of both the Sponsor and Trustees. Thus, if the Sponsor mandatorily/ voluntarily disassociate itself from the mutual fund, someone may have to take over the responsibility of becoming signatory to the future amendments to the trust deed:

i. A provision may be included in trust deed to govern future amendments to trust deed. This provision may specify manner in which future amendments will be carried out. One example of such provision could be to require the largest shareholder to designate his nominee for the same.

- ii. In case of future amendments, a resolution may be passed in a Board Meeting or AGM designating a nominee to sign trust deed on behalf of AMC (as self-sponsor) for carrying out fundamental changes in the trust deed. However, it may not provide any authority to the nominee and nominee may be a mere signatory subject to requisite prior approvals. The requirement of unitholder approval for amendment to trust deed (except in case of change in control) may continue to apply to protect unitholder's interest.

B. Public Comments

- a. The influence of the Sponsor even after disassociation to be decided as per the provisions of the Companies Act. The companies Act has provided adequate measures to address conflict of shareholders and directors. It would be appropriate to introduce e-voting for significant matters affecting unitholders interest.
- b. No shareholder should have disproportionate rights to appoint a director
- c. The definition of "control" in the Regulations speak about 'majority of directors'. Even if there are board nominees from a disassociated ex-sponsor, unless an entity controls majority of the board, substantial conflict will not arise. In any event, there are provisions in the Companies Act which are in place to address situations of conflict of interest and those would continue to remain applicable and act as safeguards. This point is also relevant for the conflict of interest provisions envisaged for PEs and their group companies. Those provisions must also be aligned to majority board representation and or controlling interest, rather than pegging it at 10%.
- d. Media articles have suggested exit of sponsor must vest AMCs with responsibilities and fiduciary duties of the sponsor, in cases where investors need to be compensated for mismanagement or SEBI levies penalties for regulatory infractions.
- e. Instead of the largest shareholder nominating a person to become signatory to the trust deed, upon disassociation of the sponsor, the AMC

should become signatory to the trust deed in order to ensure continuity and avoid logistical problems associated with change of signatory upon change in the largest shareholder time and again.

- f.** In the case of a Trust the role of the sponsor is that of author of the trust and limited to the creation of Trust
- g.** Approaching the unitholders for all changes in a Trust Deed may not be feasible. SEBI may define the material scenarios (adversely affecting the unitholders' interest) that would require unitholders' approval. Any person, specifically authorised by the Board of Directors of the AMC in this regard may sign the Trust Deed as Self Sponsor.
- h.** In case of listed AMC where the sponsor has disassociated itself from the AMC, mirror image of shareholding may not be possible. The largest non-public shareholders may be required to mirror their stakes in AMC with that of the Trustee company.
- i.** In case of Self-sponsored AMCs, the schemes of mutual fund can be the shareholders of Trustee company, which would avoid the need of change in the shareholding structure of Trustee company consequent to the change in the shareholding of AMC.
- j.** There is no minimum net worth requirement for a Trustee Company keeping in view that the role of trustee is fiduciary / supervisory in nature rather than of undertaking financial obligations of the mutual fund operations. Thus, the present eligibility criteria regarding 2/3rd of Trustee Board of Directors to be independent of the Sponsor may continue. Mandatory disassociation of sponsor from trustee company may be challenging as this is a "not-for-profit" company and would be unlisted even where AMC may be listed. So it would be difficult to find shareholders for the same.
- k.** There cannot be a situation where there is a change in shareholding in the AMC but no such change in the Trustee Company. This would be a reasonable business risk which may be imposed on a Sponsor seeking disassociation. It should also be mandated that the incoming shareholder for the AMC should be the same as that in the Trustee. Thus, every

transaction with respect to the shares of the AMC would have to be mirrored in the Trustee Company.

- I. Board of self-sponsored AMCs may have at least 60% independent directors.

C. Consideration of Issues

- a. The maximum shareholding/ voting rights of any single shareholder may also be limited to 10% to avoid conflicts as mentioned in the proposal under section 4.7 above.
- b. If the maximum shareholding/ voting rights is limited to less than 10%, no shareholder will have any control over the AMC. Because as per the MF Regulations, control is any direct or indirect ownership, control or holding shares carrying not less than 10% of the voting rights.
- c. The suggestion regarding having at least 60% independent directors in the Board of self-sponsored AMCs may be accepted with partial modification i.e. at least 2/3rd directors needs to be independent director. Because post reduction of stake of the sponsor in the AMC, the sponsor may still exert undue influence on the AMC through various means irrespective of its shareholding in the AMC. But with the presence of majority of independent directors, such conflicts including the disproportionate right of shareholders can be avoided.
- d. In case of trustee companies of a MF with listed AMC, the financial investors shall continue to hold shares in the trustee company that is a mirror image of their holding in the AMC. Further, the shareholding in the trustee company that is equivalent to the public shareholding in the AMC shall be held with a trust whose beneficial owner would be the erstwhile Sponsor and whose trustees shall be the Independent directors of the trustee company.
- e. Schemes of MF becoming shareholders of trustee company as suggested may not be consistent with the objectives of the scheme.

- f. It may not be appropriate for the AMC to be the signatory of trust deed. Instead, the largest financial investor may be the signatory to the trust deed instead of the sponsor.
- g. The control in respect of the trustee company of a listed AMC and an unlisted AMC has been depicted in following table:

	AMC With Sponsor	Self- Sponsored AMC
Unlisted AMC	Sponsor controls trustee company.	<p>Erstwhile sponsor does not control the trustee company.</p> <ul style="list-style-type: none"> • Shareholding less than 10%. • Two- third independent directors in the Board of directors of the Trustee company.
Listed AMC	Sponsor controls trustee company.	<p>Erstwhile sponsor does not control the trustee company.</p> <ul style="list-style-type: none"> • Financial investors shall continue to hold shares in the trustee company that is a mirror image of their holding in the self sponsored AMC i.e. less than 10%. • Shareholding in the trustee company equivalent to the public shareholding in the AMC to be held with a trust whose beneficial owner would be the erstwhile Sponsor and whose trustees shall be the Independent directors of the trustee company. • Two- third independent directors in the Board of directors of the Trustee company.

D. Proposal

- a. Post disassociation, the upper limit of shareholding for any Financial Investor may be capped at 10% and at least 2/3rd directors needs to be independent director on the board of Self- Sponsored AMC in order to ensure that no shareholder have any controlling stake in AMC.
- b. In case of trustee companies of a MF with unlisted AMC, the shareholding of Trustee Company shall be a mirror image of the shareholding of AMC at all times.

- c. In case of trustee companies of a MF with listed AMC, the financial investors shall continue to hold shares in the trustee company that is a mirror image of their holding in the AMC. Further, the shareholding in the trustee company that is equivalent to the public shareholding in the AMC shall be held with a trust whose beneficial owner would be the erstwhile Sponsor and whose trustees shall be the Independent directors of the trustee company.
- d. Upon disassociation of the sponsor, the largest financial investor shall be the signatory to the trust deed instead of the sponsor.

4.10. Repeal of Regulation 38 of MF Regulations, 1996

A. Proposal

There is no such Guaranteed Return scheme managed by any AMC. Further, there are significant risks associated with such schemes that would, in effect function like shadow banks. Thus, it is proposed that the provisions of Guaranteed Return schemes mentioned at Regulation 38 of MF Regulation be deleted.

- 4.11.** The summary table including issues being addressed in the current Board Memorandum regarding the roles and responsibilities of the sponsor and the proposed resolution of those issues is placed at **Annexure B**.

5. Proposals for consideration

- 5.1.** The Board may consider and approve the proposals at paragraphs 4.1.D, 4.2.D, 4.3.D, 4.4.D, 4.5.D, 4.6.D, 4.7.D, 4.8.D, 4.9.D, 4.10.A above. Draft amendments to the SEBI (Mutual Funds) Regulations, 1996, and the draft notification for the proposed amendment are placed at **Annexure C1** and **Annexure C2** respectively.

- 5.2.** The above requirements at paragraphs 4.1(D), 4.2(D) and 4.3(D) and 4.10(A) may be enabled through amendment to SEBI (Mutual Funds) Regulations, 1996 and other proposals may be enabled by issuance of a circular.
- 5.3.A** Reasonable time may be provided for implementation to facilitate stakeholders to have required systems in place.
- 5.4.** The Board may authorize the Chairperson to take steps to implement the proposal by amending the MF Regulations, with consequential and appropriate change, as may be required, and to notify the necessary regulations and/ or issue circular/(s) in this regard.

This section has been excised.

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