भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CIRCULAR

SEBI/HO/IMD/IMD-PoD-2/P/CIR/2023/118 **July 07, 2023**

To

All Mutual Funds/

Entities desirous of becoming Sponsor of a Mutual Fund

All Asset Management Companies (AMCs)/

All Trustee Companies/ Boards of Trustees of Mutual Funds/

Association of Mutual Funds in India (AMFI)

Dear Sir/ Madam,

Subject: Regulatory Framework for Sponsors of a Mutual Fund

1. In order to enhance the penetration of the Mutual Fund industry, and to facilitate new types of players to act as sponsors of Mutual Funds, an alternative set of eligibility criteria is introduced. This is with the objective of facilitating fresh flow of capital into the industry, fostering innovation, encouraging competition, providing ease of consolidation and easing exit for existing sponsors.

2. In this regard, a Working Group was formed by SEBI to examine the aforesaid issues. The recommendations of the Working Group were deliberated in the Mutual Funds Advisory Committee (MFAC) and subsequent to that, SEBI (Mutual Funds) Regulations, 1996 ("MF Regulations") have been amended vide notification No. SEBI/LAD-NRO/GN/2023/134 dated June 26, 2023.

3. In furtherance to the same, the following has been decided:

A. Deployment of liquid net worth by Asset Management Company (AMC)

i. In terms of Regulation 21(1)(f) of the MF Regulations, an AMC shall deploy the minimum net worth required, as applicable, in assets as may be specified by SEBI.

ii. In this regard, the following has been decided:

a. AMCs shall deploy the minimum net worth required either in cash, money market instruments, Government Securities, Treasury bills, Repo on Government securities, 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 on a continuous basis and such investments shall be unencumbered.

B. Acquisition of an AMC

i. In terms of Regulation 7 (a) (iii) of the MF Regulations, in case of change in control of an existing AMC due to acquisition of shares, the sponsor shall ensure that the positive liquid net worth of the sponsor or funds tied up by the sponsor is to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher.

ii. In this regard, the following has been decided.

a. In case of change in control of an existing AMC due to acquisition of shares, the cost of acquisition may also be funded out of borrowings by a sponsor but in such cases, the sponsor shall have sufficient other assets to encumber for borrowings other than the shares of the proposed AMC.

b. The sponsor's stake in the proposed AMC shall be free from any encumbrance at all times.

iii. In terms of clause (iv) to the first proviso to Regulation 7 (a) of the MF Regulations, the sponsor has to ensure that in case of acquisition of an existing AMC, the sponsor shall have minimum positive liquid net worth equal to incremental capitalization required to ensure minimum capitalization of the AMC and the positive liquid net worth of the sponsor or the funds tied up by the sponsor are to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher.

iv. In this regard, the following has been decided.

a. In case of change in control of the existing AMC due to acquisition of shares, the cost of acquisition may be funded out of borrowings by a sponsor but the sponsor shall have sufficient other assets to encumber for borrowings other than the shares of the proposed AMC.

b. 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.

c. The sponsor's stake in an AMC shall be free from encumbrances in any form at all points of time.

C. Pooled Investment Vehicle as sponsor of Mutual Funds

i. Second proviso to Regulation 7 (a) of the MF Regulations permits to allow a private equity fund or a pooled investment vehicle or a pooled investment fund to sponsor Mutual Funds subject to conditions as may be specified by SEBI from time to time.

ii. In this regard, the following has been decided.

a. Among the pooled investment vehicles, only the private equity funds (PEs) can sponsor a Mutual Fund.

b. Such PEs shall comply with clauses (i) to (vi) of the first proviso to clause 7 (a) of the MF Regulations.

c. For any PE to qualify as a Mutual Fund sponsor, the following criteria shall be applicable;

I. The applicant PE (scheme/ fund) shall itself be a body corporate or, a body corporate set up by a PE. The applicant body corporate may be set up in India or abroad.

II. The applicant PE or its manager shall have a minimum of five years of experience in the capacity of fund/investment manager and an experience of investing in the financial sector, where it should have managed committed and drawn-down capital of not less than INR 5,000 Cr. as on the date of its application made to SEBI.

d. The following additional safeguards shall also be applicable for PEs acting as Mutual Fund sponsor.

I. There shall be no off-market transactions between the schemes of the Mutual Fund and

a) Sponsor PE; or

b) Schemes/ Funds managed by the manager of the sponsor PE; or

c) Investee Companies of schemes/ funds of sponsor PE, where it holds more than 10% stake; or has a board representation or a right to nominate Board representation.

II. As per clause (ii) of the first proviso to Regulation 7(a) of the MF Regulations, an initial shareholding of sponsor equivalent to capital contributed to an AMC to the extent of not less than INR 150 Cr. shall be locked-in for a period of 5 years. In such cases, the lock in period of

5 years shall continue in case of transfer of sponsorship to any other entity within the PE group provided all the criteria required for a PE to act as sponsor are met by the transferee PE as well.

III. The said lock in period of 5 years shall also be applicable to the shareholding of PE in the corporate entity, which is sponsoring the Mutual Fund.

IV. The experience, track record and eligibility regarding the fit and proper criteria of any applicant PE to become sponsor of a Mutual Fund shall be ascertained through its conduct in the respective home jurisdiction.

D. <u>Reduction of stake and disassociation of sponsor</u>

i. Considering the evolution of the Mutual Fund industry and significant shift in the nature of roles and responsibilities of the AMCs in the last few decades, most of the AMCs can be stated to be prepared enough to stand on their own and create trust among their investors. In view of the above, it has been decided to allow a sponsor to voluntarily reduce its stake in an AMC subject to certain conditions.

ii. Regulations 7C (1) and 7C (2) of the MF Regulations permit a sponsor to disassociate itself from an AMC and a Mutual Fund and allow such AMC of an existing Mutual Fund to act as sponsor of the same Mutual Fund in the event of the sponsor disassociating itself from the AMC.

iii. In view of the above, it has been decided that an AMC can become a “self-sponsored AMC”, subject to fulfilling the following conditions:

a. The AMC should have been carrying on business in financial services for a period of not less than 5 years;

b. The AMC should have positive net worth in all the immediately preceding five years;

c. Net profit of the AMC 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 5 years should be at least INR 10 cr.

iv. Any sponsor proposing to disassociate should have been a sponsor of the concerned Mutual Fund for at least 5 years before the proposed date of disassociation;

v. The shareholding proposed to be reduced by a sponsor shall not be under any encumbrance or lock-in.

vi. Any sponsor proposing to disassociate may undertake to reduce shareholding below 10% from the proposed date of disassociation as per the following timelines:

   a. Within a period of 5 years in case of listed AMCs.
   b. Within a period of 3 years in case of unlisted AMCs.
   c. During the above period, the obligations of an outgoing sponsor shall be as per the applicable regulatory framework for a sponsor.
   d. The sponsor shall commit to a graded stepwise reduction over the applicable time period.

vii. Post disassociation of any sponsor from an AMC, all the shareholders of such AMC shall be classified as “financial investors” and there shall not be any sponsor of such AMC.

viii. Post disassociation, the upper limit of shareholding for any financial investor shall be below 10%.

ix. Any sponsor proposing to disassociate itself shall undertake to honour all the obligations applicable to it under Regulation 38 of MF Regulations (Guaranteed Returns) as on proposed date of disassociation.

x. A self- sponsored AMC shall maintain the minimum net worth requirement as per SEBI MF Regulations on a continuous basis.

xi. The statutory auditor of a Mutual Fund shall submit a compliance report on the fulfilment of eligibility criteria by a self- sponsored AMC, as defined at paragraph D (iii) above on an yearly basis. The trustees and Board of a self- sponsored AMC shall provide a compliance status to SEBI in the half yearly and quarterly compliance reports furnished by them respectively.

xii. The constitution of trustee company of a self- sponsored AMC shall be as under:

a. In case of trustee company of a MF with an unlisted AMC, the shareholding of trustee company shall be a mirror image of the shareholding of the AMC at all times.

b. In case of trustee companies of a MF with a 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 shall be the erstwhile sponsor with Independent directors of the trustee company as its trustees.

xiii. Regulation 14 of the MF Regulations has been amended specifying signatory to the trust deed in case of disassociation of the sponsor. In this regard, it has been decided that upon disassociation of the sponsor, the largest financial investor shall be the signatory to the trust deed instead of the sponsor.

E. Re- Association of the Sponsor(s)

i. Regulation 7C (5) of the MF Regulations provides for the dissociated sponsor as described at paragraph (D) above or any new entity to become sponsor of the Mutual Fund managed by the self- sponsored AMC, in case the AMC fails to meet the conditions specified at paragraph D (iii) above.

ii. In this regard, for the scenarios mentioned at paragraph E (i) above, it has been decided that a disassociated sponsor and/or any new entity can become sponsor of a Mutual Fund subject to the following conditions:

a. If the AMC fails to meet the criteria of self-sponsored AMC as defined at paragraph D (iii) above, a cure period of one year shall be provided within which, the AMC shall be required to meet the criteria for self-sponsored AMCs.

b. If even after the cure period, the AMC fails to meet the conditions for self-sponsored AMCs, then either the disassociated sponsor or any new entity shall become sponsor of the concerned Mutual Fund.

c. The proposed sponsor should meet all the requirements and obligations specified in MF Regulations pertaining to the sponsors and,

d. The proposed sponsor shall follow due process of obtaining approval as a sponsor from SEBI.

iii. In such cases, an exit option shall be provided to the unitholders of the existing schemes of the concerned Mutual Fund, without any exit load.

4. Applicability

All provisions except paragraph 3 (A) of this circular shall come into force with effect from August 1, 2023. Paragraph 3 (A) of this circular shall come into force with effect from January 1, 2024.

5. This circular is issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992, read with the provisions of Regulation 77 of SEBI (Mutual Funds) Regulations, 1996, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

Yours faithfully,

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