



Consultation Paper on Review of Regulatory Framework for Sponsors of a Mutual Fund

A. Objective

The objective of this consultation paper is to seek comments / views from the public on the proposals intending to review the regulatory framework for sponsor(s) of a mutual fund so as to explore the possibility of enabling diverse set of entities, who otherwise may not have been eligible, to be associated with mutual funds with requisite safeguards in place.

B. Background

- I. 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 a mutual fund such as obtaining necessary approvals, funding, incorporating and setting up asset management company as per the conditions of the in-principle approval, establishing mutual fund trust and Trustee Company, etc.
- II. Regulation 7 of SEBI (Mutual Fund) Regulations, 1996 ('MF Regulations') provides the eligibility criteria for the sponsors of a mutual fund as under:

"Eligibility criteria

7. For the purpose of grant of a certificate of registration, the applicant has to fulfill the following, namely—

(a) the sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions.

Explanation: For the purposes of this clause "sound track record" shall mean the sponsor should—

(i) be carrying on business in financial services for a period of not less than five years; and

(ii) ensure that the networth is positive in all the immediately preceding five years; and

(iii) ensure that the networth 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, the networth of the sponsor is more than the aggregate par value or market value of the shares so acquired, whichever is higher; and

(iv) the sponsor has profits after providing for depreciation, interest and tax in three out of the immediately preceding five years, including the fifth year:

Provided that the applicant shall have a networth not less than rupees one hundred crore in case the aforementioned requirement is not fulfilled.



(aa) the applicant is a fit and proper person;

(b) in the case of an existing mutual fund, such fund is in the form of a trust and the trust deed has been approved by the Board;

(c) the sponsor has contributed or contributes at least 40% to the net worth of the asset management company:

Provided that any person who holds 40% or more of the net worth of an asset management company shall be deemed to be a sponsor and will be required to fulfill the eligibility criteria specified in these regulations;

(d) the sponsor or any of its directors or the principal officer to be employed by the mutual fund should not have been guilty of fraud or has not been convicted of an offence involving moral turpitude or has not been found guilty of any economic offence;

(e) appointment of trustees to act as trustees for the mutual fund in accordance with the provisions of the regulations;

(f) appointment of asset management company to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations;

(g) appointment of custodian in order to keep custody of the securities or goods or gold and gold related instrument or other assets of the mutual fund held in terms of these regulations, and provide such other custodial services as may be authorised by the trustees."

- III. The regulations require the Sponsor to compensate the affected investors and/or the scheme for any unfair treatment to any investor as a result of inappropriate valuation as under:

"25(20) The asset management company and the sponsor of the mutual fund shall be liable to compensate the affected investors and/or the scheme for any unfair treatment to any investor as a result of inappropriate valuation."

- IV. The regulations require the Sponsor to hold at least 40% stake in an AMC on a continuous basis. MF Regulations cast an obligation on Sponsor as under:

"Guaranteed returns

38. No guaranteed return shall be provided in a scheme, —

(a) unless such returns are fully guaranteed by the sponsor or the asset management company;

(b) unless a statement indicating the name of the person who will guarantee the return, is made in the offer document;



(c) the manner in which the guarantee is to be met has been stated in the offer document.”

- V. Further, Regulation 7B (1) of MF Regulations restricts the sponsors from owning more than 10% stake directly or indirectly in more than one AMC as under:

“Norms for Shareholding and Governance in Mutual Funds

7B. (1) No sponsor of a mutual fund, its associate or group company including the asset management company of the fund, through the schemes of the mutual fund or otherwise, individually or collectively, directly or indirectly, have –

(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.”

- VI. The above requirements were put in place over time to ensure that only sponsors with a reputation above reproach and having adequate financial wherewithal, qualify for setting up mutual funds. In view of the changing landscape of the mutual fund industry, a proviso was included in the MF Regulations in year 2021 so that the applicant was facilitated to sponsor a mutual fund even if the profitability track-record condition of eligibility was not met, provided that the applicant had a positive net worth of not less than rupees one hundred crore.
- VII. Over the years, it has been observed that once a mutual fund has acquired a threshold of AUM and existence, the sponsors’ obligations gradually reduce to insignificant activities (such as signatory to trust deed). By this time in the business cycle, the AMC shows self-sufficiency and maturity in running its operations in the interest of the unitholders. The table below analyses the role of the sponsor of the mutual fund envisaged at a nascent stage of the mutual fund industry versus the current period after completion of 3 decades of regulatory evolution under SEBI:

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 going forward, the provision for such schemes is expected to be phased out. Hence, sponsor’s role is not 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 AMCs 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.	AMCs 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.	AMCs 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. For instance, UTI MF and IDBI MF when introduced long time ago were backed with reputed names.	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.

- VIII. The need of sponsor during initial years till AMC starts meeting all the obligations is high and gradually reduces as AMC matures. Once AMCs achieve enough experience, the Sponsor seems to take a step back and limits its role to that as an investor.
- IX. To further the penetration of the Mutual Fund industry, a need has been felt to enable new players, who otherwise may not have been eligible to act as sponsor, by introducing an alternative set of eligibility requirements. 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.

C. Issues for Public Consultation

A working group was formed by SEBI to examine the aforesaid issues. Draft recommendations of the Working Group were placed before the Mutual Fund Advisory Committee ('MFAC'). The final recommendations made by the working group, after incorporating the comments of MFAC, are summarized below along with issues placed for public consultation.



1. Eligibility Criteria for Sponsor

Regulation 7 of MF Regulations provides the eligibility criteria for the sponsors of a mutual fund which emphasizes on sound track record, general reputation of fairness and integrity in all business transactions, putting in place necessary resources for setting up of a mutual fund, fit and proper requirements, etc. as mentioned above.

The Working Group, after detailed study of various requirements and global best practices, recommended a two-pronged approach. It has recommended that while the existing eligibility requirements be further strengthened to ensure that only high quality entities qualify, an alternative set of eligibility requirements may also be introduced to enable qualification of entities including Private Equity funds who do not qualify based on the main eligibility criteria to be considered as sponsors. However, the alternative set of eligibility requirements should be such that there is no regulatory arbitrage.

The main eligibility criteria proposed are as under:

1.1. Main Eligibility Criteria

1.1.1. Sound track record

- 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.
- 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

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.



(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.

1.1.2. All other existing requirements (including Fit and Proper Requirements) are adequate and do not need review. Fit and Proper Requirements have been recently reviewed by SEBI for all intermediaries by way of amendment to SEBI (Intermediaries) Regulations, 2008.

1.1.3. 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.

Consultation No. 1

Whether the proposed strengthening of the existing eligibility requirements is in order? Any modification in the proposed eligibility requirements may be suggested with accompanying rationale.

1.2. Alternate Eligibility Criteria

The Working Group felt that the Alternate Eligibility Requirements for Sponsors should be focused on what the sponsor can contribute to the mutual fund business. The primary thought process behind the alternate requirements is 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.) so that the mutual fund business does not have to rely on the Sponsor in initial years.

1.2.1. The Working Group deliberated on the alternative criteria as under:

1.2.1.1. Capitalization of AMC: Existing eligibility requirements for setting up a new mutual fund/ AMC require AMC net worth to be at least INR 50 cr. for sponsors meeting profitability criteria and INR 100 cr. for sponsors not meeting profitability criteria (AMC shall be required to have a net worth of 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). Considering that the track record of the sponsor as mentioned in the existing route is not being considered for alternate eligibility route, the net worth requirement for the AMC should be at least INR 100 cr. to ensure that it is not less stringent than the main eligibility requirements. It was also observed that average expenses of the recently incorporated AMCs were approximately around INR 10 cr. per year. Hence, a top up of INR 50 cr. (INR 10 cr. * 5 years) be added to the requirement of INR 100 cr. to cover for operational expenses of the AMC for the first 5 years without requiring



financial support from the sponsor. Therefore, INR 150 Crores appears to be a reasonable requirement as it will create sufficient entry barriers and at the same time is not too steep for any serious applicant. INR 150 cr. is also a logical extension of existing requirements of INR 50 cr. net worth for existing route and INR 100 cr. requirement for non-profitable companies. In view of the above, the proposed Sponsor should adequately capitalize the AMC such that the net worth of AMC is not less than INR 150 cr.

1.2.1.2. Lock-in of minimum capital contribution in AMC: In order to avoid the possibility of regulatory arbitrage where the proposed sponsor capitalizes the AMC at the time of application and withdraws the capital soon thereafter, the 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. The lock-in requirement would act as a filter to weed out non-serious entities and would eliminate the possibility of 'license trading' (where an eligible entity sets up a mutual fund in its name and subsequently transfers it to another entity). Further, the minimum sponsor stake of 40% shall also be locked in within the same period of 5 years.

1.2.1.3. Contribution of Human Capital: Considering that with sufficient capital funding the AMC should be able to attract high quality human capital, initial contribution of human capital by the Sponsor is important and indispensable to ensure that right culture is seeded in the mutual fund and also to ensure that initial set of AMC obligations are sufficiently honored. Further, considering that track record of sponsor may no longer be required in the Alternate Eligibility Criteria, it is imperative that the said track record be substituted with human capital requirement. Therefore, the Sponsor should appoint sufficiently experienced personnel in AMC such that the total experience of Chief Executive Officer, Chief Operating Officer, Chief Regulatory Officer and all the fund managers combined should be at least 30 years.

1.2.1.4. Acquisition of existing AMC by sponsor not meeting the main eligibility requirements:

- a. In case of proposed acquisition of stake in existing AMC, where the proposed sponsor does not meet the main eligibility requirements, the proposed sponsor should meet the requirement of adequate capitalization of AMC as detailed above. This will ensure that there is no inconsistency in the requirement for acquiring an AMC and setting up a new AMC.
- b. In case of acquisition of stake in existing AMC, the sponsor should have minimum net worth equal to incremental capitalization required to ensure minimum AMC capitalization and should be able to demonstrate



the firm commitment (by way of 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. For example, assume an AMC has net worth of +INR 70 cr. and manages a substantial AUM/ has significant growth potential, and the proposed sponsor acquires it for INR 2000 cr. In case of a proposed sponsor applying through alternate eligibility route, the sponsor should have net worth of at least INR 80 cr. (additional INR 80 cr. capitalization required to bring AMC net worth to +INR 150 cr.) and firm commitment of INR 2000 cr. (acquisition price).

1.2.1.5. Fit and Proper Requirements: Fit and Proper requirements (including compliance with FATF recommendations) applicable under main eligibility route should apply *mutatis mutandis* to the proposed sponsors under alternate eligibility route.

1.2.2. In view of the above, the following are proposed as alternate eligibility criteria for sponsor of MF:-

- 1.2.2.1. The proposed Sponsor should adequately capitalize the AMC such that the positive liquid net worth of AMC is not less than INR 150 cr.
- 1.2.2.2. The AMC shall be required to have a positive liquid 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 positive liquid net worth requirement shall required to be maintained by the AMC on a continuous basis.
- 1.2.2.3. The sponsor shall be responsible to ensure that AMC is in compliance with maintaining minimum positive liquid net worth.
- 1.2.2.4. The 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 within the same period of 5 years.
- 1.2.2.5. the Sponsor should 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.
- 1.2.2.6. In case 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 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.

1.2.2.7. Fit and Proper Requirements to be fulfilled.

Consultation No. 2

Is there a need for introduction of the Alternate Eligibility Criteria? If yes, are the proposals in this regard sufficient? Any modification in the proposed alternate eligibility requirements may be suggested with accompanying rationale.

2. Private Equity Funds/ Pooled Investment Vehicles/ Pooled Investment Funds (PE) as Sponsor

The Working Group noted that PE with significant capital can 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. Hence, the Working Group agreed that PE, if facilitated, can add value to the Mutual Fund Industry in India.

Further, 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. The Working Group also noted that PEs may act as a Sponsor to Real Estate Investment Trusts or Asset Reconstruction Companies and that IRDAI has issued specific Guidelines in 2017 allowing PEs and AIFs to be promoters of insurance companies. Recently, IRDAI has introduced guidelines providing more flexibilities to PE funds enabling them to invest in insurance sector and has introduced provisions by which promoters will be allowed to dilute its stake down to 26% from current requirement of 50% on condition that the insurer has a satisfactory solvency record for the preceding five years and is a listed entity². In view of the same, the Working Group deliberated on the possibility of a PE directly sponsoring the Mutual Fund and additional safeguards required, if any.

The Working Group recommended that PE should fulfil the alternate eligibility route and should meet all the requirements prescribed therein to qualify as sponsor of a mutual fund. In addition to the requirements under alternate eligibility route, the Working Group recommended following additional criteria/ safeguards shall be made applicable to for PEs qualify as mutual fund sponsor:

² Press note of IRDAI dated November 25, 2022- "Insuring India by 2047 - New landscape for Insurance Sector"



Additional Criteria

SEBI (Mutual Funds) Regulations, 1996 require mutual funds to be constituted in the form of a trust and require the trust deed to be executed by the sponsor in favour of the trustees. While PE can be a body corporate or trust, as per Section 7 of Indian Trust Act, 1882, a trust may be created only by a person competent to contract. Hence, 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. The applicant body corporate could be set up in India or abroad.

- 2.1. PE or its manager should 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 should also have managed committed and drawn-down capital of not less than INR 5,000 Crore as on the date of the application.
- 2.2. 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” shall, in addition to the existing requirements, also includes any of the following:
 - 2.2.1. “Associate” or “Group Company” of the Manager of the sponsor PE
 - 2.2.2. Investee Companies in which the shareholding held by the Schemes/ Funds managed by Manager of the proposed sponsor PE is 10% or more
 - 2.2.3. Any investee company in which sponsor PE has more than 10% Investment or the Directors of sponsor PE/ corporate sponsor has Board representation

Additional Safeguards

- 2.3. No off-market transactions should be permitted between the schemes of MF 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.
- 2.4. The Mutual Fund sponsored by the PE should 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.
- 2.5. The lock-in period of 5 years for minimum sponsor stake proposed under the alternate eligibility route is 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 should also be applicable to the shareholding of PE in the corporate entity/ SPV which is sponsoring the Mutual Fund, as the case may be. In other words, lock in will be



applicable to both the investments by the PE in corporate entity/SPV as well as in AMC.

- 2.6. 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 shall apply.

Consultation No. 3

Is there a need for permitting PEs to sponsor Mutual Funds? Please provide rationale for your response.

Consultation No. 4

Do you agree with the proposed additional criteria for PEs to qualify as mutual fund sponsor? Provide your comment separately for each of the criteria along with supporting rationale.

Consultation No. 5

Do you agree with the proposed additional safeguards for PEs acting as mutual fund sponsor? Provide your comment separately for each of the safeguard along with supporting rationale.

3. Role of Sponsor after AMC matures

- 3.1. The Indian Mutual Fund Industry has now gained sufficient maturity to debate separation of Sponsor from AMC and to gauge if AMCs are prepared to stand on their own gradually and create trust among investors. It is observed that more than 90% of the AMCs have already completed more than 5 years of operation, have 5 year financial services track-record and sufficient liquid net worth. As mutual funds mature and the AMCs become more independent, the responsibility cast upon sponsors could be reduced. Further, from the ownership requirements of Banks and Market Infrastructure Institutions, it is observed that maximum ownership is usually capped below 50% to keep the influence of one large owner on the investee entity dealing with public money in check. One of the terms of reference of the Working Group was to deliberate upon mandatory reduction of ownership of the Sponsor in AMC and manner of such reduction.
- 3.2. The working group undertook cost-benefit analysis of reduction in stake of Sponsor which is summarized as under:



Benefits	Adverse effects
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.	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).
Strategic Guidance: The presence of other significant shareholders may bring in strategic guidance and good talent to fuel growth and innovation, and expand the presence of mutual funds including driving inclusive growth. These will lead to better value for everyone.	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.
Improved Corporate Governance: The investor usually will have some board representations due to their substantial investments in the Mutual Funds, thereby improving overall corporate governance of the mutual funds.	Conflict among Multiple Shareholders: The misalignment of interests among multiple Investors can lead to stalemate in decision making or even worse value-dilutive decision making arising out of competitive behaviour.
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 which would indirectly also benefit the unitholders.	Short-term focus: The 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.
	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.
	Demotivating Serious Entities: With mandatory reduction of stake requirements,



	the serious entities may not be interested in selling up stakes in Mutual Funds.
	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.
	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.

3.3. The Working Group felt that the ideal balance is to not require mandatory reduction in Sponsor stake but to let the market dynamics decide the ownership composition. Accordingly, the Working Group recommended as under:

- 3.3.1. The reduction of Sponsor's stake in AMC should be voluntary and left to the market dynamics. Hence, no suggestion on phased stake reduction was made.
- 3.3.2. Present requirement for minimum 40% ownership to be retained by the Sponsor in AMC is reasonable and does not require review.
- 3.3.3. Considering that the reduction in stake of sponsor in AMC is voluntary, the same applies to Sponsor's stake in Trustee *mutatis mutandis*.

3.4. There are several ways in which association/ activities of Sponsor may conflict with MF operations. Few illustrative conflicts are tabulated below:

Sl. No.	Conflict Description	Conflict Example
1	MF schemes investing in Sponsor/ Associate and Group Companies of Sponsor – While the investments made by the schemes may be within the prudential limits, but some of the investments may not be in the interest of the investors i.e., had it not been connected to the sponsor, MF scheme may not have made the investment.	MF scheme making investment into stressed bonds of Sponsor, its associate and group companies even when other better investment opportunities are available.
2	MF Schemes investing in public issues/ fund raising of Sponsor, its associate and group companies.	Prudent investment amount in public issue of sponsor, its associate and group companies may be INR 100 cr., but MF



	– The investment made may be more than reasonable investment amount and/or timed to avoid the failing of the public issue/ fund raising.	scheme invests INR 500 cr. or MF scheme invests to fill the unsubscribed portion at the last moment.
3	Sponsor, its associate or group companies may use the potential of the mutual fund schemes to invest in companies where they are appointed as merchant banker for any fund-raising activity by such companies.	Indirectly mutual fund schemes are being influenced by the sponsor, its associate or group companies where either of them has been appointed as a merchant banker for any fund-raising activity.
4	MF Schemes subscribing to the services of Sponsor, its associate and group companies at terms which are not at arm's length	MF scheme taking the service of Sponsor Group broker/ research/ distribution network at higher commission rates.
5	MF schemes investing in an independent company's securities which in turn finances either the sponsor, its associate or group companies	MF schemes investing in debt instruments of an independent bank/ Company, which in turn gives loan to sponsor, its associate or group companies at favorable terms.
6	Sponsor nominees on AMC/ Trustee Board have a legal obligation to protect and promote sponsor interests. Sponsor nominees along with some of the independent directors appointed by Sponsor together may be able to influence the AMC/ Trustee Board in taking decisions which are beneficial to sponsor but not to unit holders.	Listing of AMC would accrue benefits to Sponsor but will add to compliance burden on AMC, which may lead to higher fees being charged from MF schemes.
7	Information asymmetry – The sponsor always would have some information which is not available to the unit holders. Thus, unit holders may be at informational disadvantage while deciding on proposals related to MF scheme.	When AMC proposes winding up of any scheme, it may not be clear whether the winding up is in the interest of sponsor or the unit holders. During the voting for winding up of a mutual fund scheme, only the information statutorily required to be disclosed will be disclosed to the unit holders. However, the sponsor may have other material information which may be relevant for informed decision making by the unit holders.
8	Presence of Sponsor/ large shareholders may curb managerial discretion which may lead to suboptimal investment decision making	A sponsor may enforce additional investment restrictions (to protect its brand, assets) which may lead to AMC investing in low-risk instruments or not investing in particular investment category. This may lower the return to



		unitholders but safeguards the interest of the Sponsors.
9	The sponsor would appoint/ influence the decision of appointing the directors/ key employees with whom he is comfortable in dealing with irrespective of whether it is in the best interest of the unit holders or not.	Sponsor appointing persons known to him as independent directors of AMC/ trustee company. This 'independent' directors may protect the interest of sponsor more than the unitholders.
10	Because of MF schemes providing business to some third-party, the third-party provides subsidized services to Sponsor Group Companies.	A MF scheme subscribes to research from an equity research company at market rates. Considering that MF scheme has subscribed, the equity research company may offer subsidized rate to sponsor-related wealth management company.
11	Insider Trading/ Front running	Sponsor Group Companies indulging in Insider Trading/ Front running by taking advantage of access to MF scheme personnel/ systems/ processes.
12	Sponsor influencing voting by MF schemes in companies in which sponsor has interest	The sponsor and the MF scheme both may hold 5% in XYZ Ltd. The sponsor may influence voting decisions of MF schemes to protect his investment irrespective of whether the same is in the interest of the unit holders or not.

3.5. In the light of para B(VII) on role of sponsor, in the current stage of MF industry there may be grounds to conceive that reduction in stake of the sponsor in AMCs may yield certain benefits. An AMC's own goodwill, trust and financial strength acquired over a period of time (mature AMCs) make it independent of its sponsor. In case of listed companies, reclassification of promoters to public shareholders is permitted subject to satisfying certain eligibility criteria (such as shareholding below specified threshold, non-exercise of control, etc.).

Consultation No. 6

Is there a need for reduction in stake of the sponsors of mature AMCs to reduce sponsor-related conflicts? If yes, please indicate appropriate value for specified threshold (26% or 10%) and provide supporting rationale for your response.

Consultation No. 7

Will the reduction in stake of the sponsors of mature AMCs be in the interest of the unitholders? Provide supporting rationale for your response.



Self-Sponsored AMC

3.6. 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:

- 3.6.1. should be carrying on business in financial services for a period of not less than five years;
- 3.6.2. shall have positive liquid net worth in all the immediately preceding five years;
- 3.6.3. 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 should be at least INR 10 cr.
- 3.6.4. Sponsor(s) proposing to disassociate should have been a Sponsor(s) of the concerned mutual fund for at least 5 years before the proposed date of disassociation;
- 3.6.5. Sponsor(s) proposing to disassociate shall undertake to reduce shareholding below specified threshold within a specified time from the proposed date of disassociation;
- 3.6.6. The shareholding proposed to be reduced by the Sponsor(s) should not be under any encumbrance or lock-in.
- 3.6.7. Sponsor(s) proposing to disassociate itself will have to 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.
- 3.6.8. AMC proposing to become a Self-Sponsored AMC would have to 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.

Consultation No. 8

Please consider each eligibility condition for becoming a Self-Sponsored AMC described at para 3.6 and provide your comments separately for each of the condition along with supporting rationale.

Consultation No. 9

Is there a need for any other eligibility condition/ safeguards for becoming a Self-Sponsored AMC? If yes, please indicate the same and provide supporting rationale for your response.

Consultation No. 10



One of the condition for Sponsor(s) proposing to disassociate itself is to reduce its shareholding in a specified time. Please indicate appropriate time for specified time and provide supporting rationale for your response.

3.7. The aforementioned reduction in stake of the sponsor may be achieved in following two ways:

3.7.1. Voluntary reduction in stake of the sponsors:

- a. AMC/ Sponsor will have liberty to apply for disassociation of existing sponsors by meeting the qualifying conditions.

3.7.2. Mandatory reduction in stake of the sponsors:

- a. The reduction in stake will be a regulatory requirement and any mutual fund meeting the qualifying conditions for becoming a Self-Sponsored AMC will be mandatorily required to ensure that stake of the sponsors is reduced below specified threshold within prescribed timelines.
- b. A mutual fund meeting the qualifying conditions for Self-Sponsored AMC cannot on-board any sponsor till it continues to satisfy qualifying conditions for Self-Sponsored AMC. It can only have “Financial investors” each holding shares up to specified threshold.
- c. When a mutual fund which met the qualifying conditions for Self-Sponsored AMC fails to satisfy qualifying conditions for Self-Sponsored AMC, it can on-board a sponsor (past or new) subject to meeting all the requirements and obligations pertaining to the Sponsors.

3.8. In either of the above reduction methodologies some of the mutual funds will continue to have sponsors and others will not. This may require two sets of compliance requirements depending on whether the sponsor has disassociated itself or not.

3.9. When the Sponsor is voluntarily permitted to disassociate itself from the mutual fund:

- 3.9.1. The disassociating sponsor shall reduce its shareholding in asset management company and trustee company below the specified threshold.
- 3.9.2. The disassociating sponsor provides an exit option to the unitholders of the existing schemes of the concerned Mutual Fund, without any exit load.
- 3.9.3. The disassociating sponsor may be considered as “Financial investor” and no obligation of sponsor will apply to the disassociating sponsor after disassociation.
- 3.9.4. The shareholding of AMC (held by the disassociating Sponsor or any other shareholders) can be freely exchanged with other Investors without any restrictions/ prior approval.



- 3.9.5. 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.*
- 3.9.6. In case obligation has already been incurred for Guaranteed returns schemes under Regulation 38, it shall continue to be borne by the disassociating Sponsor till the existence of such scheme.
- 3.9.7. Obligation already incurred to compensate the affected investors and/or the scheme for any unfair treatment to any investor as a result of inappropriate valuation under Regulation 25(20) up to the period ending on the date of disassociation shall continue to be borne by the disassociating Sponsor even after disassociation.
- 3.10. When the Sponsor is mandatorily required to disassociate itself from the mutual fund and reduce its shareholding in asset management company and trustee company below the specified threshold:
- 3.10.1. The disassociating sponsor would be required to mandatorily reduce its shareholding in asset management company and trustee company below the specified threshold within a prescribed transition period.
- 3.10.2. No exit option to the unitholders of the existing schemes of the concerned Mutual Fund required subject to suitable disclosure about the transition at least 30 days in advance.
- 3.10.3. The disassociating sponsor may be considered as “Financial investor” and no obligation of sponsor will apply to the to the disassociating sponsor after disassociation.
- 3.10.4. The shareholding of AMC (held by the disassociating Sponsor or any other shareholders) can be freely exchanged with other Investors without any restrictions/ prior approval.
- 3.10.5. The requirement of Regulation 7B(2) of MF Regulation would continue to apply.



3.10.6. In case obligation has already been incurred for Guaranteed returns schemes under Regulation 38, it would cease to apply to the disassociating sponsor after following due process as may be specified by SEBI.

3.10.7. Obligation already incurred to compensate the affected investors and/or the scheme for any unfair treatment to any investor as a result of inappropriate valuation under Regulation 25(20) shall continue to be borne by the disassociating Sponsor up to the period ending on the date of disassociation.

Consultation No. 11

If the reduction in stake of the sponsors is to be implemented, which mechanism (Voluntary/ mandatory) is more desirable? Provide supporting rationale for your response.

Consultation No. 12

Please consider each aspect of voluntary disassociation of the Sponsor described at paras 3.7.1 & 3.9 and provide your comment separately for each of the aspect along with supporting rationale.

Consultation No. 13

Please consider each aspect of mandatory disassociation of the Sponsor described at paras 3.7.2 & 3.10 and provide your comment separately for each of the aspect along with supporting rationale. Further, please comment on reasonable period (no. of years) which may be provided to qualifying sponsors so as to facilitate graded exit.

Consultation No. 14

Please consider upper limit (26% or 10%) and lower limit (5%) for shareholding by the Investors in an AMC after disassociation of the Sponsor and provide your comment for each limit threshold along with supporting rationale. The upper and lower limits are expected 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.

3.11. Control over AMC and MF operations by disassociated sponsor/ financial investor

3.11.1. Once the sponsor has disassociated from the mutual fund operations, it is imperative that the sponsor no longer controls or influences the operations of the mutual fund. In order to ensure that mutual fund business is conducted independently and professionally:



- a. Stipulate reduction in the shareholding of all shareholders (including that of the disassociated sponsor) in AMC and Trustee Company to below a specified threshold so that the control exercised by any shareholder is not substantial.
- b. 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.
- c. 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 shall initiate suitable enforcement action against such shareholder.

3.11.2. In view of the above voluntary or mandatory disassociation of sponsor, some of the mutual funds will continue to have sponsors and others will not. Accordingly, the role and obligation of sponsors and financial investors for an AMC having sponsor vis-à-vis a Self- Sponsored AMC may be summarized by way of following Grid:

Status of AMC Entity	AMC having Sponsor	Self-Sponsored AMC
Sponsor	• Sponsor required to hold minimum 40% shareholding in AMC • All requirements/ obligations of Sponsor shall apply. Sponsor shall be responsible for ✓ compensating for inappropriate Valuation ✓ eligibility requirements ✓ maintenance of minimum liquid net worth of AMC on continuous basis • Restriction of 10% cross holding in other MFs to continue to apply.	• No sponsor • AMC shall be responsible for ✓ compensating for inappropriate Valuation ✓ eligibility requirements ✓ maintenance of minimum liquid net worth of AMC on continuous basis • Restriction of 10% cross holding in other MFs to continue to apply.
Financial Investors	• Other investors entitled to hold below 40% shareholding in AMC and Trustee	• Any investor entitled to hold below specified threshold shareholding in AMC and Trustee



	• No requirements/ obligations of Sponsors apply • Not to exercise control over AMC • Restriction of 10% cross holding in other MFs to continue to apply.	• No requirements/ obligations of Sponsors apply • Not to exercise control over AMC • Restriction of 10% cross holding in other MFs to continue to apply.
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Consultation No. 15

Please consider various conflicts possible due to continued influence of the Sponsor even after disassociation and provide your comment on the possible ways of eliminating the control that may be exercised by nomination of directors to the Board of AMC, while maintaining compliance with the Companies Act.

3.12. Legal implications of disassociation of Sponsor:

3.12.1. 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, the contract cannot be unilaterally modified and any amendment requires concurrence of all the contracting parties. Hence, any amendment to trust deed of a mutual fund would require concurrence of both the Sponsor and Trustees.

3.12.2. Thus, if the Sponsor mandatorily/ voluntarily disassociate itself from the mutual fund, someone will have to take over the responsibility of becoming signatory to the future amendments to the trust deed. To resolve this, 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.

3.12.3. In case of future amendments, a resolution will 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 does not provide any authority to the nominee and nominee will 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) shall continue to apply to protect unitholder's interest.

Consultation No. 16



Please consider legal implications of disassociation of the Sponsor described at para 3.12 and provide your comment on whether you agree with the same along with supporting rationale.

You are also requested to specifically comment on proposed solution of requiring the largest shareholder to designate his nominee to become signatory to trust deed to ensure that disassociation of sponsor does not create any legal challenge in the functioning of the mutual fund. You may also suggest any other mechanism to address the aforesaid legal implications.

You are further requested to comment on any other legal aspect of disassociation of sponsor not covered in this paper.

3.13. Impact of disassociation of Sponsor on ownership of the Trustee Company:

3.13.1. Presently, Sponsor's shareholding in AMC and Trustee Company are mirror image of each other. If the Sponsor mandatorily/ voluntarily disassociates itself from the AMC, its implication on ownership in Trustee Company requires consideration. Any difference in shareholding pattern of AMC and Trustee Company can create different types of conflicts and may not be in the interest of the unitholders.

3.13.2. One of the mechanisms to address this is to require that the change of shareholding of AMC shall 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.

Consultation No. 17

Please consider the impact of disassociation of Sponsor on ownership of the Trustee Company described at para 3.13 and provide your comments on whether you agree with the same along with supporting rationale.

You are also requested to specifically comment on the proposed solution of requiring the exchange of shareholding of AMC to also mandatorily require exchange of shareholding of Trustee Company.

You are further requested to comment on any impact of disassociation of Sponsor on ownership of the Trustee Company not covered in this paper along with possible mitigation mechanisms.

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



3.14.1. A disassociated sponsor and/or any new entity can 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'.
- d. An exit option is provided to the unitholders of the existing schemes of the concerned Mutual Fund, without any exit load.

Consultation No. 18

Please consider each condition of Re-Association of the Sponsor(s) described above and provide your comment separately for each of the conditions along with supporting rationale.

A. Public Comments

- I. Comments are invited from the members of the public on the above issues in order to take into consideration the concerns of various stakeholders while finalizing the proposals.
- II. Comments may be sent by email to sponsor_public_comments@sebi.gov.in and/or to Ms. Kritika, Assistant Manager (kritika@sebi.gov.in) no later than January 29, 2023 with the subject line "Comments on Consultation Paper on Review of Regulatory Framework for Sponsors of a Mutual Fund"
- III. The comments should be sent by email in MS Excel file in the following format only:
[Link To Download This Format](#)

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