

Use of liquid mutual funds for compliance with deposit requirement by Investment Advisers and Research Analysts

1. Objective

- 1.1. This memorandum seeks approval of the Board to provide flexibility to Investment Advisers (IAs) and Research analysts (RAs) to use units of liquid mutual funds, as an option to the bank deposit, for compliance with the deposit requirements under SEBI (Investment Advisers) Regulations, 2013 ('IA Regulations') and SEBI (Research Analysts) Regulations, 2014 ('RA Regulations') respectively.

2. Background

- 2.1. In terms of regulation 8 of IA Regulations and RA Regulations, IAs and RAs are required to maintain a deposit of a sum as specified by SEBI from time to time. Compliance with the deposit requirement is one of the conditions for registration as IA/RA. This requirement is required to be fulfilled on a continuous basis to keep the registration in force.
- 2.2. Such deposit is required to be maintained with a scheduled bank, marked as a lien in favour of the Investment Adviser Administration and Supervisory body (IAASB) or Research Analyst Administration and Supervisory body (RAASB), as the case may be. The existing IAs and RAs are required to comply with deposit requirements by June 30, 2025.
- 2.3. In terms of regulation 8 of IA Regulations and RA Regulations, deposit shall be available for utilization in case the IA/RA fails to pay dues emanating out of arbitration and conciliation proceedings, if any, under the Online Dispute Resolution (ODR) Mechanism or such other mechanism as may be specified by SEBI.
- 2.4. SEBI has received representations from IAs and RAs wherein they have highlighted certain operational difficulties in opening the fixed deposit accounts and lien marking of the same in favour of Administration and Supervisory Body (ASB). Some of the difficulties cited are as follows:

- i. Non-uniform interpretation of third-party fixed deposit (FD) procedures across different bank branches;
- ii. Delays in issuance of necessary FD letters/documents by banks and acknowledgement of lien;
- iii. Inconsistencies in interest payout options at different branches of banks;
- iv. Limited awareness among bank staff about the SEBI-mandated lien marking requirements.

2.5. IAs and RAs have represented that in addition to the option to maintain the deposit with the bank, they may be allowed to use units of liquid mutual fund that may be lien marked in favour of ASB for compliance with the deposit requirement.

3. **Public consultation:**

3.1. In view of the representations from IAs and RAs, SEBI issued a consultation paper on May 09, 2025 (**Annexure A**) proposing to allow IAs and RAs to use units of liquid mutual funds along with the fixed deposit for compliance with the deposit requirements under IA Regulations and RA Regulations.

3.2. It was noted in the consultation paper that-

- i. Liquid mutual fund units are by nature liquid and may be considered low-risk and less volatile instruments. Further, lien can be marked on liquid mutual fund and hence they can be made available for utilization under the ODR mechanism.
- ii. The operation of lien and invocation of lien on units of liquid mutual fund remains within the securities market ecosystem bringing in more efficiency.
- iii. Mutual fund folios can be opened and operated digitally as well as in demat. Asset Management Companies (AMCs) provide such facilities on their websites and apps that can be accessed through internet on mobile phones/computers.

3.3. It was proposed in the consultation paper that -

- i. Lien marked liquid mutual fund units may be accepted as deposit for compliance with the deposit requirement under IA Regulations and RA Regulation. Lien on such units of mutual fund shall be marked for at least one year. These units of liquid mutual can be in the form of Statement of Account (SOA) or in demat mode, at the option of an IA/RA.
- ii. The mutual funds units are valued based on the Net Asset Value (NAV) of the mutual fund unit and the eligible amount of deposit for lien marking shall be the value of units of liquid mutual fund reduced by such haircut as may be decided by ASB and applicable exit load, if any.
- iii. The value of the mutual fund units for calculating the eligible amount of deposit shall be reviewed every year as per the guidelines for deposit requirement. In case of any decrease in value of mutual fund below the threshold deposit requirement or the deposit requirement increases due to increase in the number of clients, IA/RA shall be required to replenish the deposit amount within a specified period of such a review by marking the lien on the additional units of the liquid mutual funds proportionate to the additional deposit requirement in favour of ASB.

4. Analysis of public comments:

- 4.1. SEBI received responses from 19 entities/persons which include various stakeholders such as IAs, RAs, industry associations, investors, mutual funds and MII. All responses are in favour of the proposals in the consultation paper.
- 4.2. The comments in favour of the proposal inter alia mention that -
 - i. Lien marking on units of mutual fund units for compliance with deposit requirement enables control to recover the funds from IAs/RAs.
 - ii. Liquid funds satisfy the requirement of stable assets and shall be the additional asset class available for IAs/RAs to comply with deposit requirement.
 - iii. The proposal will remove operational hindrances to the entry level individuals/entities to start an IA/RA business.

4.3. Some of the respondents have made certain suggestions in the proposals. These suggestions and SEBI response to these suggestions are given below:

Sr. No.	Suggestions	SEBI response
1	SEBI should also allow arbitrage funds for the purpose of compliance with deposit requirement as they have the similar risk and liquidity profile as liquid funds. Given that the lien is for minimum period of one year, arbitrage funds shall have better after tax returns for IAs and RAs.	Liquid funds invest in short-term market instruments like treasury bills, government securities and commercial papers having maturity of 91 days or less. The redemption can be done on T+1 basis and hence they are more liquid than other types of mutual funds. The main purpose of liquid funds is to offer the option to cash out at any time in case of a need. Arbitrage funds primarily invest in equity and equity related instruments and works on the price differential across markets. Their redemption is on T+2 basis like other categories of mutual funds. Industry representation has been received to allow use of liquid mutual funds for compliance with deposit requirement as the same is in line with the policy to allow investment in safe liquid fund only.
2	Since the liquid funds will be kept pledged for a period of 1 year or more with review every year it is suggested that the holdings of these funds be only in demat form with the lien also automatically flowing in through the demat route. The advantage on adopting this measure is easy monitoring and reporting for the auditors if any as well as the regulator.	Mutual funds in Statement of Account (SOA) or in the demat fall under the securities market ecosystem and accepted forms of holding. Restricting the mutual funds only in demat format is not intended and shall not provide any additional benefit or flexibility to IAs and RAs. Hence it may also be allowed in SOA form.

3	The paper does not seem to mention about the ability of the IA or RA switching one liquid fund with another to ensure easy liquidity and maneuverability of the instruments that needs to be pledged or switched. In any case the pledgee by virtue of having to apply appropriate haircuts etc. would be able to take care of such changes. This would also help both the pledgee and the pledger if the existing liquid fund is downgraded or merged with some other AMC and carries higher risk etc.	The one- year period for lien marking has been proposed to improve operational efficiency and provide an additional option to the IAs and RAs. Frequent change in lien marking and revocation may add additional burden on operational and human resources.
4	The value of underlying liquid funds after haircut should be monitored on ongoing basis.	Due to short tenure and nature of the underlying instruments, the NAV of liquid mutual funds is considered less volatile. Continuous monitoring of value of underlying liquid mutual funds shall lead to considerable operational and compliance challenges. Applying a specified hair cut on the published NAV of the liquid fund will take care of any volatility obviating the need for continuous monitoring. In view of this, it is proposed that the value of the mutual fund units for calculating the eligible amount of deposit shall be reviewed every year.
5	Lien marking or invocation or release process should be detailed out by SEBI or ASB in consultation with other stakeholders including mutual funds and Registrar and Transfer Agents (RTAs).	Lien marking/lien renewal or invocation or release process shall be detailed by ASB in consultation with SEBI and other stakeholders.

6	Whether the required deposit amount can be kept partially in the form of fixed deposit and partially in the form of units of liquid mutual funds.	For the purpose of operational efficiency and ease of compliance, the deposit amount shall be allowed only in any one form i.e. either fixed deposit or units of liquid mutual funds. This position can be revised once we gain experience.
7	Considering that the exit load may vary based on AMC or type of scheme, instead of applying both the exit load and haircut, only a uniform haircut as may be specified may be made applicable while obtaining deposits through units of liquid mutual funds.	In view of the suggestion, the proposal is revised to apply only haircut as may be specified by ASB for the purpose of deposit requirement.

5. **(This has been excised for reasons of confidentiality)**

6. **Proposals for consideration and approval of the Board:**

6.1. In view of the industry representations and public comments, the following is proposed for consideration and approval of the Board.

- i. For the purpose of compliance with the deposit requirement under IA Regulations and RA Regulations, as an option to the deposit to be maintained with the scheduled bank, IAs and RAs may provide units of liquid mutual fund marked as lien in favour of ASB.
- ii. The terms and conditions of the manner of keeping the liquid funds marked as lien shall be specified in a circular.
- iii. If deemed appropriate, in addition to the existing options, SEBI may allow IAs and RAs to provide the deposit in any other form or instrument for compliance with the deposit requirements under IA Regulations and RA Regulations, as may be specified.

6.2. It is proposed to implement the aforesaid provisions by making the amendments to IA Regulations, RA Regulations and through the issuance of circular(s) thereunder. Draft amendment to the IA Regulations, RA Regulations are placed at **Annexure B**.

6.3. The amendments to the IA Regulations and RA Regulations are proposed to be effective from the date of their publication in the official gazette. The provisions of the circular are proposed to be effective from the date of issuance of the circular.

7. **Proposal**

7.1. The Board is requested to consider and approve the proposals at paragraphs 6.1 and 6.3 mentioned above in the Memorandum and authorize the Chairperson to take necessary steps for implementation of the decisions of the Board.

Annexure A

(Consultation paper is available on SEBI website www.sebi.gov.in at Reports & Statistics » Reports » Reports for Public Comments)

Annexure B

(Amendments shall be notified after following the due process)