Corpsec Hotline

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SEBI ALLOWS PRIVATE EQUITY FUNDS TO BECOME MUTUAL FUND SPONSORS

INTRODUCTION

The Securities and Exchange Board of India ("SEBI"), pursuant to its board meeting dated March 29, 2023[1], approved certain amendments to the SEBI (Mutual Funds) Regulations, 1996 ("MF Regulations"). SEBI will now allow private equity funds/ pooled investment vehicles/ pooled investment funds (collectively, the "PE Funds") to be associated with mutual funds in the capacity of a sponsor, with requisite safeguards in place. In this backdrop, SEBI had released a consultation paper on review of regulatory framework for sponsors of a mutual fund ("SEBI Consultation Paper")[2], seeking public views on SEBI's proposed changes.

WHO IS A SPONSOR?

A sponsor in terms of Regulation 2(x) of the MF Regulations means any person who, acting individually or in concert with another body corporate, establishes a mutual fund[3]. A sponsor is responsible for all the steps for setting up a mutual fund which include, obtaining necessary approvals, funding, incorporating and setting up asset management company, establishing mutual fund trust etc.

Currently, Regulation 7 of the MF Regulations provides the eligibility criteria for the sponsors of a mutual fund, which, inter alia,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, and etc. The SEBI Consultation Paper has deliberated on strengthening the existing eligibility criteria for a sponsor, however, for the purposes of this article, we have emphasised on the alternate eligibility criteria proposed by SEBI to allow PE Funds to become sponsors of a mutual fund.

THE NEED TO INCLUDE PE FUNDS AS SPONSORS

The PE Funds 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 in India. The PE Funds may also provide constructive competition to the current entities in the mutual fund industry and improve value to investors.

The SEBI Consultation Paper deliberated that, in the recent past, PE Funds have been indirectly holding stake in sponsor of mutual funds. Further, sponsors looking for an exit from the mutual fund business have not been able to find good offers from entities other than the PE Funds. Accordingly, allowing the PE Funds to act as sponsors of mutual funds (with additional safeguards in place), will not only add value to the mutual fund industry but will also enable the existing sponsors with better exit opportunities.

ALTERNATE ELIGIBILITY CRITERIA

The SEBI Consultation Paper has proposed an alternative set of eligibility requirements to enable qualification of entities including PE Funds, who do not qualify based on the existing eligibility criteria, to be considered as sponsors of mutual funds. The following are proposed as alternate eligibility criteria for sponsors of mutual funds:

1. The proposed sponsor should adequately capitalise the asset management company ("AMC"), i.e. the minimum contribution should not be less than INR 150 crore.
2. The AMC shall be required to have a positive liquid net worth of not less than INR 100 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 be required to be maintained by the AMC on a continuous basis.
3. The sponsor shall be responsible to ensure that AMC is in compliance with maintaining minimum positive liquid net worth.
4. The capital contributed to the AMC to the extent of minimum required (i.e. up to INR 150 crore) 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.
5. The Sponsor should appoint sufficiently experienced personnel in the 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.
6. In case of acquisition of an 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.

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7. Fit and Proper requirements applicable under the existing eligibility route will also apply to the proposed sponsors under alternate eligibility route.

Additionally, the SEBI Consultation Paper, inter alia, recommended the following additional criteria/ safeguards to be made applicable to PE Funds to qualify as mutual fund sponsors:

1. PE Fund 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. In case of a mutual fund wherein majority is owned by a PE Fund, the definition of "Associate" or "Group Company" shall also include the following:
   - "Associate" or "Group Company" of the Manager of the sponsor PE Fund;
   - Investee companies in which the shareholding held by the Schemes/ Funds managed by Manager of the proposed sponsor PE Fund is 10% or more; and
   - Any investee company in which sponsor PE Fund has more than 10% investment or the directors of sponsor PE Fund/ corporate sponsor has board representation.
3. No off-market transactions should be permitted between the schemes of MF and
   - Sponsor PE Funds; or
   - Schemes/ Funds managed by the manager of the sponsor PE Funds; or
   - Investee companies of schemes/ funds of sponsor PE Funds where it holds more than 10% stake; or has a board representation.
4. The mutual fund sponsored by the PE Funds 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 Funds have an investment of 10% or more or has a board representation.

CONCLUSION

We understand that SEBI realised that in order to further the penetration of the mutual fund industry, there was a need to enable new players including the PE Funds, who otherwise may not have been eligible to act as sponsor. This step should in turn facilitate fresh flow of capital into the industry, foster innovation, encourage competition and provide ease of consolidation and easing exit for existing sponsors.

– Harman Khorana & Ratnadeep Roychowdhury

You can direct your queries or comments to the authors

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[1] SEBI Board Meeting dated March 29, 2023, available at: https://www.sebi.gov.in/media/press-releases/mar-2023/sebi-board-meeting_69552.html.

[2] Consultation Paper on Review of Regulatory Framework for Sponsors of a Mutual Fund dated January 13, 2023, available at: https://www.sebi.gov.in/reports-and-statistics/reports/jan-2023/consultation-paper-on-review-of-regulatory-framework-for-sponsors-of-a-mutual-fund_67334.html.

[3] Regulation 2(x) of the SEBI (Mutual Funds) Regulations, 1996.

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