

Consultation paper for Review of SEBI (Collective Investment Schemes) Regulations, 1999

1. Objective

The objective of the consultation paper is to seek comments / views from the public on the proposals that are intended to strengthen the regulatory framework for Collective Investment Schemes (CIS) as well as empower the Collective Investment Management Company (CIMC) to effectively discharge their responsibilities towards the investors of the schemes.

2. Background

- 2.1. Many companies had been raising capital from investors through issuance of Agro bonds, plantation bonds which were in the form of CIS, but without providing adequate protection to investors.
- 2.2. Accordingly, SEBI notified SEBI (Collective Investment Schemes) Regulations, 1999 (hereinafter called as “CIS Regulations”), consequent to recommendations made by Dave Committee, a Committee under the Chairmanship of Dr. S. A. Dave.
- 2.3. As per CIS Regulations, CIMC is an entity incorporated under the Companies Act, 1956 and registered with the Board under CIS regulations, whose object is to organise, operate and manage a CIS. No person other than a CIMC, which has obtained a certificate under these regulations, shall carry on or sponsor or launch a CIS.
- 2.4. The objective of the CIS Regulations, inter alia, is to lay down the framework for CIMCs who act in a fiduciary capacity towards their clients. CIMCs are required to comply with various requirements such as net-worth criteria, representation on board of self as well as other CIMCs, disclosures, custodial compliances, scheme appraisal, maintenance of records, etc.
- 2.5. The structure of CIS is a two-tier one. There are two entities involved in the process- the CIMC and Trustees. CIMC is created to float and manage a CIS. Subsequently, trustee is appointed as guardians of fund and assets. CIMC manages funds as per the scheme mandate and Trustees monitor the activities of the CIMC and check its regulatory compliances.
- 2.6. CIS is a pooled investment vehicle in closed ended investment space and the units of the schemes are to be listed on exchange. With no limit on minimum investment by the investor, retail investors are the primary target investor base for CIS. The same provides an avenue to the investors to have a professionally managed pooled investment vehicle through which they can have exposure to a wide variety of underlying assets. However, this investment strategy also exposes the investors to a wide array of risks associated with their underlying assets.
- 2.7. Just like CIS, Mutual Funds are also structured as pooled investment vehicles with the underlying investment being “Securities” as defined under section 2(h) of Securities Contracts (Regulation) Act, 1956.
- 2.8. SEBI (Mutual Funds) Regulations, 1996 (hereinafter called as “MF Regulations”) notified in the year 1996 to regulate mutual funds have since undergone several amendments and various

circulars have been issued thereunder, broadly to enhance transparency and disclosures, to address the emerging issues, to improve operational efficiency, to protect the interest of investors, to facilitate development and growth and to strengthen the regulatory framework for mutual funds in India, etc.

- 2.9.** On the other hand, CIS Regulations, notified in the year 1999, have not been reviewed since then. With a view to removing any regulatory arbitrage among various pooled investment vehicle as available to the retail investors, it is important that the regulatory requirement for CIS as a pooled investment vehicle should be aligned or matched with those for Mutual Funds.

3. A comparison was done between the regulatory provisions applicable for Mutual Funds and CIS, which are detailed below.

3.1. Track record and Net-worth of the CIMC

Criteria / Particulars	Mutual Fund	CIS
Track record	Sponsor Track Record: a) In financial services > 5 years. b) Positive Net-worth in immediately preceding 5 years c) Current net-worth > proposed capital contribution in AMC d) Profitability of Sponsor – 3 out of 5 years including 5 th year	No such provision in CIS
Net-worth of AMC	Minimum INR 50 crore shall be maintained continuously Minimum INR 100 crore, if sponsor is not meeting profitability criteria	Minimum INR 3 crore at the time of registration, to be increased to INR 5 crore within 3 years of grant of registration to be maintained continuously

Currently, there is no requirement to have previous track record of the applicant (CIMC) in terms of carrying the relevant business or previous years net-worth or profitability. Further, CIS regulations require applicant to have a net worth of not less than rupees five crores, whereas in case of AMC of a Mutual Fund minimum required net-worth is rupees fifty crore.

Proposal:

- Whether it can be mandated that the CIMC or its promoters shall meet the following criteria with respect to track record and net-worth;
 - a) shall be carrying out the business in the relevant field, in which CIS schemes are proposed to be launched, for a period not less than five years
 - b) the net-worth is positive in all the immediately preceding five years
 - c) has profits after providing for depreciation, interest and tax in three out of the immediately preceding five years, including the fifth year
 - d) Minimum net-worth of the CIMC shall be INR 50 Crores and shall be maintained continuously

3.2. Conflict of interest

Criteria / Particulars	Mutual Fund	CIS
Conflict of interest	<p>Sponsor of a mutual fund, its associate or group company including AMC shall not have</p> <p>a) 10% or more shareholding in other AMC or Trustee company of any other Mutual Fund</p> <p>b) representation on the board of AMC or trustee company of any other Mutual Fund</p> <p>Shareholder holding 10% or more of the share-holding or voting rights in the AMC or the trustee company of a mutual fund shall not have</p> <p>(a) 10% or more shareholding in other AMC or Trustee company of any other Mutual Fund</p> <p>(b) representation on the board of AMC or trustee company of any other Mutual Fund</p>	<p>No such provision restricting the shareholding in other CIMC.</p> <p>However, director of CIMC shall not be a director in any other CIMC unless such person is an independent director.</p>

There are no stipulations on the CIMC or its shareholders to not to hold controlling interest in other CIMC.

Proposal:

- Whether it can be mandated that CIMC, its shareholders holding 10 % or more, its associate or group, individually or collectively, directly or indirectly, shall not have 10% or more of the share-holding or voting rights in any other CIMC and shall not have representation on the board of the any other CIMC.

3.3. Alignment of interest

Criteria / Particulars	Mutual Fund	CIS
Alignment of interest of entity	The asset management company shall invest such amounts in such schemes of the mutual fund, based on the risks associated with the schemes.	No such provision in CIS
Alignment of interest of key employees of entity	A minimum of 20% of the salary/ perks/ bonus/ non-cash compensation (gross annual CTC) net of income tax and any statutory contributions (i.e. PF and NPS) of the Key Employees of the AMCs shall be invested in the units of Mutual Fund schemes in which they have a role/ oversight.	No such provision in CIS

In order to align the interest of the CIMC and its key employees with the unitholders of the CIS, there is a need for CIMC and its employees to invest in the CIS.

Proposal:

- Whether it can be mandated that;
 - a. CIMC shall have a continuing interest of not less than two and half percent of the corpus or five crore rupees, whichever is lower, in the form of investment in CIS.
 - b. A minimum of 20% of the salary/ perks/ bonus/ non-cash compensation (gross annual CTC) net of income tax and any statutory contributions (i.e. PF and NPS) of the designated employees of the CIMCs shall be mandatorily invested in the units of CIS in which they have a role/ oversight.
 - c. The investment by CIMC shall be maintained at all points of time till the completion of tenure of the CIS or till the CIS is wound up.
 - d. CIMCs may invest from their net-worth to fulfil the aforesaid obligations, if required. However, the CIMCs shall be required to make good the shortfall in the minimum net-worth to comply with the requirement of the CIS Regulations in case of sustenance of temporary Mark to Market loss for two consecutive quarters.

3.4. Expenses related to Scheme

Criteria / Particulars	Mutual Fund	CIS
Scheme initial issue expenses	Shall be borne by AMC	<u>Shall</u> be borne by scheme Shall not exceed 7% of the funds raised upto 8 years and 9% for more than 8 years- to be amortized
TER (Expense Ratio) to be charged to scheme	In case of close ended and interval schemes, (i) the total expense ratio of equity oriented scheme(s) shall not exceed 1.25 per cent of the daily net assets of the scheme. (ii) the total expense ratio of close ended and interval scheme(s) other than schemes specified in clause above shall not exceed 1.00 per cent of the daily net assets of the scheme.]	Management and Advisory Fees to CIMC Basic Fee - shall not exceed (a) 1 % p.a. for the first 5 years (b) 1.25% p.a. for the next 5 years (c) 1.5% for the subsequent period till the termination Incentive Fee - <= 25% of the excess returns realized over and above the indicative returns

Criteria / Particulars	Mutual Fund	CIS
		Other Expenses- RTA fee, Trustee Fees and expenses, Audit fees; Rating and Appraisal fees; Listing fees; other direct incidental cost approved by Trustees are to be charged to scheme;

In order to align the expenses related to the scheme, there is a need for CIMC to review the expenses.

Proposal:

- Whether it can be mandated that;
 - a. Initial Issue expense shall be borne by scheme not exceeding 2% of fund raised
 - b. Expenses and fee to be charged to scheme as below may be capped at 2%
 - i. Management and Advisory Fees
 - ii. Registrar services for transfer of units sold or redeemed;
 - iii. Fees and expenses of trustees;
 - iv. Audit fees;
 - v. Subsequent Rating and Appraisal fees;
 - vi. Listing fees;
 - c. Other direct costs, if any, which are **incidental to the operation** of the CIS, may be charged to scheme as approved by trustee;
 - d. No incentive fee based on performance of the scheme shall be charged to the scheme.

3.5. Minimum number of investors and minimum subscription amount for a CIS

Criteria / Particulars	Mutual Fund	CIS
Minimum Subscription amount	INR 10 crore – equity schemes INR 20 core – debt schemes	No limits defined, however subscription amount to be disclosed in the offer document
Minimum Number of investors	Min. 20 investors and Max. 25% per investor	No provision in CIS

Currently, CIS Regulations do not mandate minimum number of investors, maximum holding of a single investor and minimum subscription amount in any CIS. In order to avoid the potential risk of controlling the scheme by few individuals or investors, there is a need to maintain minimum number of investors in any CIS.

Proposal:

- Whether it can be mandated that;
 - a. Each CIS should have a minimum subscription amount of INR 20 Crore
 - b. Each CIS should have a minimum of 20 investors and no single investor should account for / hold more than 25% of the AUM of such scheme.
 - c. The above conditions are required to be complied immediately after the closure of the subscription list, failing which CIMC shall refund the application money to the applicants.

3.6. Maximum offer period for scheme, Allotment of units and refunds of moneys

Criteria / Particulars	Mutual Fund	CIS
Maximum offer period for scheme	15 days	90 Days
Refund the application money	Within 5 working days from the date of closure of subscription list	Within six weeks from the date of closure of subscription list
Unit certificates against allotment of units	Within 5 working days from the date of closure of the initial subscription list or from the date of receipt of the application	Within six weeks from the date of closure of the subscription list

Currently, CIS Regulations allows a longer time limit for offer period, refund of application money and allotment of unit certificates to the investors.

Proposal:

- Whether it can be mandated that;
 - a. CIS shall not be open for subscription for more than 15 days
 - b. Application money shall be refunded by CIMC within 5 working days from the date of closure of subscription list in case total of subscription of less than 90 % of the proposed subscription amount of the scheme.
 - c. Unit certificates against acceptance of application shall be allotted within as soon as possible but not later than five working days from the date of closure of the initial subscription list

3.7. Consequential and Miscellaneous amendments

Certain other incidental and clarificatory amendments may also be undertaken to remove difficulties and give effect to the above provisions and further to strengthen the regulatory framework for CIS.

4. Public Comments

- 4.1. Comments are invited from the members of the public on the proposed amendments to the CIS Regulations with the objective of taking into consideration the concerns of various stakeholders. The said comments may be offered in the following format:

Name of the person/entity proposing comments: Name of the organization (if applicable): Mobile No.: Email id:			
Sr. No.	Para of the consultation paper	Comments / suggestions	Rationale

In case of any other issues not dealt in the consultation paper may be provided in the following table:

Name of the person/entity proposing comments: Name of the organization (if applicable): Mobile No.: Email id:			
Sr. No.	Other issues	Comments / suggestions	Rationale

[Note: Kindly mention the subject of the communication as “Comments on Consultation paper for Review of SEBI (Collective Investment Schemes) Regulations, 1999 and specify whether you are a market intermediary/ participant (mention type/ category) or public (investor, academician etc.)]

- 4.2. Comments in the aforesaid format may be sent to the following, latest by January 31, 2022:

- a) By e-mail: to Shri Ritesh Kumar Chhaparia, Assistant General Manager (riteshkumarc@sebi.gov.in) and/ or Ms. Sarika Kataria, Deputy General Manager (sarikak@sebi.gov.in)
- b) By post: to the following address:
Ms. Sarika Kataria
Deputy General Manager
Investment Management Division, Collective Investment Scheme
Securities and Exchange Board of India
SEBI Bhavan, Plot No. C4-A, "G" Block,
Bandra Kurla Complex,
Bandra (East), Mumbai -400 051

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