

SEBI paves the way for specialized investment fund and mutual fund LITE regime: A new dawn for the mutual funds industry?

24 December 2024

Introduction

On 16 December 2024, Securities and Exchange Board of India (SEBI) released new rules vide the Securities and Exchange Board of India (Mutual Funds) (Third Amendment) Regulations, 2024 (MF Amendment Regulations) to the Securities and Exchange board of India (Mutual Funds) Regulations, 1996 (MF Regulations), whereby it has introduced a new breed of mutual funds called 'specialized investment funds' and a lite touch regulatory license for asset management companies who wish to manage only certain specified passive investment funds.

The amendment comes against the backdrop of the recently published consultation paper wherein SEBI had sought comments from the public on a 'new asset class', which could provide investors with a new avenue for deploying their capital, serving as a bridge between the traditional tried, tested and familiar mutual funds (which cater to retail investors with a ticket size as low as INR 500 (five hundred)) and the more sophisticated alternative investment funds and portfolio management schemes (which cater to investors with a minimum ticket size of INR 1 (one) Crore and INR 50 (fifty) lakhs respectively).

Key features of 'specialized investment funds'

Effective from 1 April 2025, specialized investment funds will be able to solicit and pool capital from investors for the purpose of making investments in accordance with a pre-determined investment strategy.

We have summarized below with certain key attributes of 'specialized investment funds':

<u>Parameter</u>	<u>Summary of applicable provision</u>
<i>Minimum Investment Amount</i>	<i>INR 10 lakh</i> , provided that this minimum threshold shall not be applicable for 'Accredited Investors'. ¹
<i>NISM Certification</i>	The fund manager of a specialized investment fund will be required to obtain the relevant NISM Certification, as may be prescribed from SEBI from time to time. Notably, these certification requirements have not been notified but are expected to be analogous to the certification required for portfolio managers under SEBI (Portfolio Managers) Regulations, 2020 and investment team members of managers of AIFs under SEBI (Alternative Investment Funds) Regulations, 2012.

¹ These investors qualify, inter alia, certain minimum income / assets / net-worth criteria prescribed by SEBI.

<u>Parameter</u>	<u>Summary of applicable provision</u>
<i>Investment Strategies</i>	These funds may be open-ended, close ended or funds with an interval investment strategy (i.e., subscription and redemption frequency appropriately disclosed in the offer document).
<i>Permissible investments²</i>	<ul style="list-style-type: none"> • <i>Equity</i>: Up to 10% (ten per cent) of the net asset value (NAV) of the fund may be invested in equity and equity related instruments of any company; • <i>Debt</i>: Up to 20% (twenty per cent) of the NAV of the fund may be invested in debt instruments comprising money market instruments and non-money market instruments issued by a single issuer which are rated not below 'investment grade' by a credit rating agency;³ • <i>Investee level concentration caps</i>: The fund cannot invest in more than 15% (fifteen per cent) of a company's paid-up capital⁴; • <i>Other permitted investments</i>: Specialized investment funds may invest in Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs), subject to a limit of up to 20% (twenty per cent) of its NAV in units of REITs and InvITs and up to 10% (ten per cent) of the NAV in units of REITs and InvITs issued by a single issuer.⁵
<i>Duties of Asset Management Companies (AMC) and Trustees</i>	<ul style="list-style-type: none"> • In addition to the customary obligations for the AMC and trustees for investor protection, specialized investment funds shall have a distinct identification and The AMCs shall also be required to maintain a separate website as may be specified by SEBI.

Mutual Funds Lite

In addition to the framework for the specialized investment funds, the MF Amendment Regulations also prescribe rules for 'Mutual Fund Lite' (also known as MF Lite) and 'Mutual Fund Asset Management Companies' (also known as Mutual Fund Lite asset management company or MF Lite AMC). A Mutual Fund lite is a mutual fund which has obtained registration under the MF Regulations which may launch only such index funds, exchange traded funds, fund of funds or other mutual fund schemes that SEBI may allow.

The MF Lite regime provides for certain key dispensations to asset management companies which do not want to raise capital for active investments and whose investment focus is limited only to passive investments.

We have summarized the key dispensations for MF Lite AMCs under the MF Amendment Regulations, while also juxtaposing the analogous criteria for AMCs under MF Regulations, as under:

² These restrictions are over and above the other investment restrictions specified under the MF Regulations, which shall continue to apply.

³ This limit may be enhanced to up to 25% of the NAV of the fund, subject to an approval from the board of trustees and board of directors of the asset management company managing the specialized investment fund. These limits will not apply for investments in government securities, treasury bills and triparty repo on government securities and treasury bills and debt exchange traded funds and other funds that SEBI may prescribe.

⁴ This limit is inclusive of the 10% limit prescribed for mutual funds under the MF Regulations.

⁵ These limits will not apply in case of investments in index fund / sector or industry specific scheme pertaining to a REIT and/or InvIT.

Parameter	Summary of applicable provision for MF Lite AMC	Summary of applicable provision for MF AMC
<p>Eligibility Criteria for Sponsors</p>	<p><u>Track Record</u></p> <p>For Sponsors with track record, they must have positive net worth in all immediately preceding 5 (five) years, ensure that positive liquid net worth is more than proposed capital contribution of the sponsor in the MF Lite AMC, <u>have net profit in 3 (three) out of immediately preceding 5 (five) years, including the fifth year, after accounting for depreciation, interest and tax</u> and have average net annual profit after depreciation, interest and tax during the immediately preceding 5 (five) years of at least <u>INR 5 (five) crore</u>.</p> <p>Sponsors not meeting the above track record may also be permitted to launch MF Lite, provided: (i) they capitalize the MF Lite AMC to <u>at least INR 75 (seventy five) crore which is locked in for an initial period of 3 (three) years</u>; and (ii) appoint relevant professionals with combined experience of <u>at least 20 (twenty) years</u>.</p> <p><u>Other conditions</u></p> <p>In addition to track record, other eligibility criteria, inter alia, fit and proper criteria, minimum sponsor contribution of at least 40% (forty per cent) of the net worth of the MF Lite AMC must also be met at all times.</p>	<p><u>Track Record</u></p> <p>For Sponsors with track record, they must be carrying on the <u>business of financial services for a period of not less than 5 (five) years</u>, have <u>positive net worth in all immediately preceding 5 (five) years</u>, ensure that positive liquid net worth is more than proposed capital contribution of the sponsor in the AMC, after accounting for depreciation, interest and tax and have average net annual profit after depreciation, interest and tax during the immediately preceding 5 (five) years of at least <u>INR 10 (ten) crore</u>.</p> <p>Sponsors not meeting the above track record may also be permitted to launch mutual funds, provided: (i) they capitalize the AMC to <u>at least INR 150 (one hundred and fifty) crore which is locked in for an initial period of 5 (five) years</u>; and (ii) appoint relevant professionals with combined experience of <u>at least 30 (thirty) years</u>.</p> <p><u>Other conditions</u></p> <p>In addition to track record, other eligibility criteria, inter alia, fit and proper criteria, minimum sponsor contribution of at least 40% (forty per cent) of the net worth of the AMC must also be met at all times.</p>
<p>Net worth requirement for MF Lite AMC</p>	<p>The MF Lite AMC must have a net-worth of at least <u>INR 35 (thirty five) Crore deployed in assets specified by SEBI, which may be reduced to INR 25 Crore if the MF Lite AMC has profits for 5 (five) consecutive years</u>.</p> <p>In case the sponsor does not satisfy the track record specified above, the applicable net worth requirement for the MF Lite AMC would be <u>INR 50 (fifty) Crore</u>.</p>	<p>The AMC must have a net-worth of at least <u>INR 50 (fifty) Crore deployed in assets specified by SEBI</u>.</p> <p>In case the sponsor does not satisfy the track record specified above, the applicable net worth requirement for the AMC would be <u>INR 100 (one hundred) Crore</u>.</p>
<p>Transactions with associated brokers</p>	<p>An MF Lite AMC shall not through any broker associated with the sponsor purchase or sell securities, which is average of <u>10% (ten per cent)</u> or more of the aggregate purchases and sale of securities made by the MF Lite in all schemes, provided the aforementioned limit shall apply for a block of any 3 (three) months.</p> <p>For trades executed through any broker (which is not a broker associated with the sponsor), the limit shall be <u>25% (twenty five per cent)</u>, unless appropriate justifications</p>	<p>An AMC shall not through any broker associated with the sponsor purchase or sell securities, which is average of <u>5% (five per cent)</u> or more of the aggregate purchases and sale of securities made by the mutual fund in all schemes, provided the aforementioned limit shall apply for a block of any 3 (three) months.</p> <p>For trades executed through any broker (which is not a broker associated with the sponsor), the limit shall be <u>5% (five per cent)</u>, unless appropriate justifications have</p>

Parameter	Summary of applicable provision for MF Lite AMC	Summary of applicable provision for MF AMC
	<p>have been recorded in writing. This limit shall apply for a block of 3 (three) months.</p> <p><i><u>SEBI may also exclude such transactions that would not be considered for the calculation of the above limits.</u></i></p>	<p>been recorded in writing. This limit shall apply for a block of 3 (three) months.</p>
<i>Restrictions on other business</i>	<p>An MF Lite AMC is not permitted to undertake any business activity other than advisory services to pooled assets in respect of passive investments, unless prior approval of SEBI is obtained to conduct such activity through a subsidiary.</p>	<p>An AMC shall not undertake any business activity other than in the nature of management and advisory services provided to pooled assets including offshore funds, insurance funds, pension funds, provident funds, such categories of foreign portfolio investor subject to such conditions, as maybe specified by the SEBI, unless prior approval of SEBI is obtained to conduct such activity through a subsidiary.</p>

Other key dispensations

An MF Lite is exempt from following the format prescribed by SEBI for the contents of the trust deed and the investment management agreement, making half-yearly disclosures and providing a half-yearly statement of portfolio to its unitholders.

Migration to MF Lite license

An existing mutual fund that intends to launch only MF Lite schemes may surrender its existing registration and migrate as a mutual fund lite under the MF Regulations. The procedure for this migration will be prescribed by SEBI in due course.

Takeaways

The MF Amendment Regulation is expected to give impetus to asset management companies, who may now launch new investment strategies under a relaxed regulatory framework. The MF Lite registration, which has relaxed the eligibility criteria and certain compliance requirements is also expected to reduce the entry barrier and allow qualified fund management entities who were earlier thwarted by constraints of the high net-worth requirements to make a foray into the passive fund management space (which has seen considerable traction over last few years due to expanding net disposable income of the working class population). The amendment is also expected to open up the hitherto closed mutual funds industry to a wider set of asset managers, creating more competition and possibly more product innovation and choices for discerning investors.

While a key ask from stakeholders of the industry to permit AIF and PMS managers to launch 'specialized investment funds' remains unaddressed in the amendment, the MF Regulations Amendment will provide savvy investors, who have a higher risk appetite with a regulated investment product, a fresh asset class to deploy capital. Concomitantly, the amendments will also provide mutual fund AMCs with a wider investor base to raise capital and a light touch regulatory framework for passive fund management.

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