SEBI Guidelines - Fintech Startups to Enter Mutual Fund Business

Why in news?

- SEBI (Securities and Exchange Board of India) recently released the amended rules governing the mutual fund industry.
- A key decision is to relax the profitability criteria for entities floating a mutual fund asset management company (AMC).

What is an asset management company?

- Asset management companies (AMCs) are firms pooling investments from various individual and institutional investors.
- The company manages the investment by investing in capital assets such as stocks, real estate, bonds, and so on.
- The asset management companies have professionals called fund managers who decide where the pooled money is invested.
- Fund managers identify the investment options that are in line with the objectives of the investors.
- **Regulation** - An AMC works under the supervision of the board of trustees.
- But, they are answerable to the capital market regulator, the Securities and Exchange Board of India (SEBI).
- While SEBI is a government body, mutual fund companies have formed the AMFI.
    - The Association of Mutual Funds in India (AMFI) is another statutory body that addresses investors' grievances.
- Every fund house must comply with the set of risk management guidelines by SEBI and AMFI.
- RBI also plays an essential role in regulating AMCs, if a bank is one of the sponsors.
- Finally, the Ministry of Finance works as the authority for all these regulators.

What are the recent changes?

- **Profitability criteria** - The SEBI has paved the way for technology startups to enter the mutual fund business by waiving the profitability requirement.
- Sponsors that are not fulfilling profitability criteria at the time of making

application shall also be considered eligible to sponsor a mutual fund.
- This is however subject to having a net-worth of not less than Rs 100 crore for the purpose of contribution towards the net-worth of the AMC.

- It is to be maintained at Rs. 100 crore until the AMC makes profits for 5 consecutive years.
    - This is aimed to encourage start-ups such as Paytm to enter the mutual fund space.
- Until now, regulators required an entrant to have 5 years of experience in the financial services business, demonstrate 3 years of profitability, and maintain a net worth of Rs 50 crore.
- **Other changes** - SEBI has approved a proposal to make it mandatory for all AMCs to maintain the minimum net worth on a continuous basis.
- At present, fund houses were required to maintain it toward the year end.
- Besides, all assets and liabilities of each scheme would have to be segregated and ring-fenced from other schemes of the mutual fund.
- This is in addition to the existing requirement of segregating bank and securities accounts.
- SEBI has also done away with the minimum promoters' contribution and subsequent lock-in requirements for issuers making an FPO (Follow on Public Offer).
- At present, promoters are mandated to contribute 20% toward FPOs.
- SEBI has also relaxed the one-year lock-in requirement for incoming investors.
- It has tweaked rules on minimum public holding norms for companies emerging out of the insolvency process.
    - Such companies would have to have at least 5% public shareholding at the time of their admission to dealing on stock exchange, as against no minimum requirement at present.
    - They would have to achieve 10% public shareholding within 12 months and 25% within three years.
    - This is a welcome move and shareholders will get at least 5% equity share as compared to zero share in a resolution plan.
- Companies undergoing insolvency resolution under the Insolvency and Bankruptcy Code (IBC) would have to make additional disclosures including -
    i. specific details of resolution plan including details of assets post-CIRP (corporate insolvency resolution plan)
    ii. details of securities continuing to be imposed on the companies' assets
    iii. other material liabilities imposed on the company
    iv. proposed steps to be taken by the incoming investor for achieving the minimum public shareholding

What is the rationale?

- SEBI has been continuously amending the rules governing the mutual fund industry over the last couple of years.
- The recent changes seek to increase penetration of the industry and improve governance at fund houses.
  - The number of mutual fund folios and demat accounts show that just 2% of the population is investing in these instruments.
  - Of the household financial savings, mutual funds account for only 7%.
  - The assets of the fund industry are also concentrated in larger cities with only 16% of these originating beyond the top 30 cities.
- The decision to relax the profitability criteria will allow companies that are constrained by their past profitability record to launch an AMC.

- With improved communication network along with the proliferation of smart phones, a large set of young investors are willing to invest through tech-enabled platforms.
- These platforms can now start an AMC to service their existing customer base.
- But, SEBI has to screen the experience, intent and past record of the promoting entity closely.

Source: The Economic Times, BusinessLine