

Consultation Paper for introduction of Mutual Funds Lite Regulations (MF LITE) for passively managed Mutual Funds Schemes

A. OBJECTIVE

The objective of this consultation paper is to seek comments / views from the public on the proposals related to introduction of a relaxed regulatory framework in the Mutual Funds (MF) segment viz, “the MF Lite Regulations” for the passively managed MF schemes. Considering the lesser risk inherent in managing passively managed MF schemes, the proposed MF Lite Regulations intend to reduce the compliance requirement, foster innovation, encourage competition and promote ease of entry for the MFs interested in launching only passive schemes.

B. BACKGROUND

- i. The SEBI (Mutual Funds) Regulations, 1996 (“MF Regulations”) and the current regulatory framework for MFs *inter-alia* provide for regulation of MFs and the schemes managed thereunder. While both active and passive MF schemes (such as Exchange Traded Funds (ETFs) and Index funds) are covered under the purview of the extant MF Regulations, the provisions thereunder have been envisaged, primarily keeping in mind the actively managed schemes and the risks and complexities associated therewith.
- ii. Management of active MF schemes *inter-alia* requires a team with expert fund managers who are responsible for defining investment philosophy and objective, security level analysis and selection, analysis of investment risks at security and portfolio level, ensuring appropriate portfolio diversification etc. The passively managed MF schemes, on the other hand, replicate an underlying index wherein the portfolios of ETFs/Index funds can be easily tracked as the underlying index compositions are available in public domain. Thus, the risks associated with passive MF schemes can be stated to be low as compared to active MF schemes.
- iii. The extant regulatory framework for MFs is however uniformly applicable for all MF schemes and does not differentiate regarding applicability of provisions relating to entry barriers (viz, net worth, track record, profitability) and other compliance requirements for entities who may be desirous of launching only passive funds.
- iv. Hence, as various provisions of the existing regulatory framework may not be relevant for passively managed schemes, a relaxed framework with light-touch regulations is *inter-alia* proposed as MF Lite Regulations for passive MF schemes, with an intent to:

- promote ease of entry
 - encourage new players
 - reduce compliance requirements
 - increase penetration
 - facilitate investment diversification
 - increase market liquidity
 - foster innovation.
- v. Under the proposed framework, MFs desirous of managing only passive schemes shall be covered under the MF Lite Regulations. However, there may be MFs existing as on date, who may opt for management of both active and passive schemes under their existing registration. Hence, to ensure uniform applicability of proposed relaxations and to provide a level playing field across all passive MF schemes, a two pronged approach has been adopted in this consultation paper, i.e.
- Ease of entry and relaxed provisions for MFs intending to launch only passive schemes under MF Lite registration. **(Section I)**
 - Ease of compliance, relaxed disclosures and other regulatory requirements for passive schemes under existing MFs as well as schemes that may be launched under the MF Lite registration. **(Section II)**

C. ISSUES FOR PUBLIC CONSULTATION

SEBI had constituted a Working Group (WG) comprising of various stakeholders including MF industry participants, to study various aspects of the extant regulatory framework for MFs and recommend a relaxed regime for passively managed MF schemes. The recommendations of the WG were also deliberated in the meeting of Mutual Fund Advisory Committee ('MFAC'). Based on the recommendations of the WG, views of MFAC and internal deliberations, the final proposals are summarized below under two sections for public consultation.

SECTION I

Section I of this consultation paper deals with the proposals pertaining to the entities intending to get registration under MF Lite Regulation to launch only passively managed schemes.

1. Eligibility criteria for a Sponsor

- 1.1. Regulation 7 of MF Regulations specifies the eligibility criteria for sponsor of an MF which *inter alia* provides two routes viz, main and alternative routes for

seeking registration to set up an MF. Salient features of both routes are as under:

Main eligibility Route (Sponsor with Financial Track record and profitability requirement)	Alternate eligibility Route – (Sponsor not meeting the main eligibility criteria)
<p><u>Requirement for sponsor:</u></p> <ul style="list-style-type: none"> ➤ Experience in financial services for minimum 5 years ➤ Networth (N/W) is positive in all the immediately preceding 5 years ➤ Positive liquid N/W is more than the proposed capital contribution of the sponsor in the AMC ➤ In case of change in control of the existing AMC due to acquisition of shares, the positive liquid N/W of the sponsor or funds tied up by the sponsor is to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher ➤ Net profit in each of the immediately preceding 5 years; and average net annual profit during the immediately preceding 5 years of at least INR 10 cr. <p><u>Requirement for AMC</u></p> <ul style="list-style-type: none"> ➤ Minimum N/W of INR 50 Cr. ➤ Minimum N/W to be deployed in liquid assets. ➤ The sponsor to hold minimum 40% of the AMC N/W. ➤ Sponsor to be responsible for maintenance of minimum positive liquid N/W of the AMC. 	<p><u>Requirement for sponsor:</u></p> <p>In case, any of the criteria is not met by the sponsor in the main route, the sponsor may apply through the alternate route, subject to the following:</p> <ul style="list-style-type: none"> ➤ Adequately capitalize the AMC such that the N/W of the AMC is at least INR. 150 Cr. ➤ Initial shareholding equivalent to INR 150 Cr. is locked-in for a period of 5 years ➤ Appoint experienced personnel in AMC such that the total combined experience of CEO, COO, CRO, CCO and CIO is at least 30 years ➤ In case of acquisition of existing AMC, the sponsor shall have minimum positive liquid N/W equal to incremental capitalization required to ensure minimum capitalization of the AMC and the positive liquid N/W of the sponsor or the funds tied up by the sponsor are to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher; and the shareholding equivalent to at least INR 150 Cr. shall be locked in for 5 years in case of acquisition. ➤ Among the pooled investment vehicles, only the private equity funds (PEs) can sponsor a Mutual Fund through alternate route subject to certain additional conditions and safeguards like applicant PE or its manager to have financial experience of a minimum of five years, shareholding lock-in for 5 years, management of drawn down capital of not less than INR 5,000 Cr. etc.

	<p><u>Requirement for AMC:</u></p> <ul style="list-style-type: none"> ➤ AMC N/W shall never fall below INR 100 Cr. and minimum N/W of INR 100 Cr. to be deployed in liquid assets. ➤ The AMC may bring the N/W down to INR 50 Cr. in case it has profit for 5 consecutive years. ➤ Sponsor to hold minimum 40% of the AMC N/W. ➤ Sponsor to be responsible for maintenance of minimum positive liquid N/W of the AMC.
<p><u>Self- Sponsored AMC</u></p> <ul style="list-style-type: none"> ➤ A sponsor may disassociate itself from its AMC after being the sponsor of the concerned Mutual Fund for at least 5 years before the proposed date of disassociation. ➤ Accordingly, the respective AMC can become a “self-sponsored AMC” subject to meeting certain conditions such as experience in financial services, positive N/W, profitability requirement etc. 	

1.2. The WG discussed the existing eligibility criteria for sponsoring a MF and N/W requirement for an AMC. Based on the recommendations of the WG and further internal deliberations, the following emerged:

1.2.1. The total expense ratio (TER) charged by the passive schemes across industry is generally around 20 bps. Hence, the TER charged on passive AUM of INR 10,000 Cr would be approx. INR 20 Cr and if 50% of the same is assumed as management fee (remaining being expenses under Regulation 52 of the MF Regulations and other permissible expenses over base TER), the revenue for an AMC shall be to the tune of INR 10 Cr. Thus, in order to earn a revenue of INR 10 Cr, AMC shall need to garner a breakeven AUM of atleast INR 10,000 Cr., which the AMC, running only passive schemes, may achieve over a period of time.

1.2.2. In view of the above, a minimum N/W of INR 35 Cr for AMCs may be appropriate under the main eligibility route as the entire amount of this N/W of the AMC shall have to be deployed in liquid assets on a perpetual basis. A lower minimum N/W shall provide a desired head start for a cost effective and competitive passive MF industry.

1.2.3. Moreover, unlike active MF schemes, passive schemes are simple and rule based by nature, therefore, financial experience of five years may not be relevant under the main eligibility route of MF Lite Regulations.

- 1.2.4. As regards the alternative eligibility route wherein sponsor's profitability and sound track record are not required to be considered, minimum N/W of INR 75 Cr for an AMC may be appropriate, which shall also be required to be deployed in liquid assets on a perpetual basis.
- 1.2.5. Considering that substantial growth in a scheme's AUM also increases the risks and responsibilities associated with its management, the AMCs may be mandated to abide by the N/W requirement as per the existing MF Regulations (i.e, as shall be applicable for MFs with active schemes) as and when the combined AUM of all schemes of the AMC under the MF Lite Regulations, exceeds INR 1 Lakh Cr.
- 1.2.6. A lock- in of 3 years of minimum shareholding of the sponsor in the AMC under the alternative eligibility route may be mandated so to ensure entry of serious players under the MF Lite regime.
- 1.2.7. As the risks associated with passively managed schemes are considerably lower than the actively managed schemes, the role of Chief Risk Officer (CRO) in such schemes is also limited from the point of view of market risk and investment risk. Therefore, under the alternative eligibility route, the AMCs may be permitted to appoint a separate CRO on a voluntary basis, else the Chief Compliance Officer (CCO) may also act as the CRO of the AMC, subject to his eligibility and experience in area of risk management. Further, the combined experience required for Chief Executive Officer (CEO), COO, CCO and Chief Investment Officer (CIO) may be relaxed to at least 20 years.
- 1.3. **Considering the above, the eligibility requirements for sponsor and AMCs under the main as well as alternative eligibility route, in the proposed MF Lite framework, are proposed to be as under:**

1.3.1. Main eligibility route for MF Lite

Requirement for Sponsor

- a. **Positive N/W in all of the immediately preceding 5 years;**
- b. **Positive liquid N/W to be more than the proposed capital contribution of the sponsor in the AMC;**
- c. **In case of change in control of the existing AMC due to acquisition of shares, the positive liquid N/W of the sponsor OR funds tied up by the sponsor; shall be to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher;**

- d. Net profit after tax in 3 out of the immediately preceding 5 years including the 5th year and average profit in the last 5 years to be at least INR 5 Cr.

Requirement for AMC

- a. Minimum N/W to be INR 35 Cr.
b. The AMC may bring the N/W down to INR 25 Cr. in case it has profit for 5 consecutive years.
- a. Minimum N/W to be deployed in liquid assets.
b. Sponsor to hold minimum 40% of the AMC N/W.
c. Sponsor to be responsible for maintenance of minimum positive liquid N/W of the AMC.

1.3.2. Alternate eligibility route for MF Lite

In case any of the criteria is not met by the sponsor under the main eligibility route as mentioned at paragraph 1.3.1 above, the sponsor may apply for registration under the alternative eligibility criteria, subject to the following:

Requirement for Sponsor

- a. The sponsor shall adequately capitalize the AMC such that the N/W of the AMC is at least INR 75 Cr.;
- b. Initial shareholding of the sponsor equivalent to INR 75 Cr. shall be locked-in for a period of 3 years;
- c. The sponsor shall appoint experienced personnel in AMC such that the combined experience of CEO, COO, CCO and CIO shall be at least 20 years. Further, AMCs may appoint a separate CRO on a voluntary basis, otherwise the CCO may also act as the CRO of the AMC, subject to his/her eligibility and experience in risk management;
- d. In case of acquisition of existing AMC,
- i. the sponsor shall have minimum positive liquid N/W equal to incremental capitalization required to ensure minimum capitalization of the AMC; AND
- ii. the positive liquid N/W of the sponsor OR the funds tied up by the sponsor; are to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher; AND

iii. The shareholding equivalent to at least INR 75 Cr. shall be locked in for 3 years in case of acquisition.

e. In case of pooled investment vehicles sponsoring a MF, management of drawn down capital by applicant PE or its manager may be relaxed to INR 2500 Cr. keeping all other conditions intact.

Requirement for AMC

- a. Minimum N/W of the AMC shall be INR 50 Cr.
- b. Minimum N/W of the AMC shall be deployed in liquid assets.
- c. The AMC may bring the N/W down to INR 25 Cr. in case it has profit for 5 consecutive years.
- d. The sponsor shall hold minimum 40% of the AMC N/W.
- e. Sponsor shall be responsible for maintenance of minimum positive liquid N/W of the AMC.

1.3.3. The extant provisions for becoming a self-sponsored AMC may be applicable under the MF Lite framework also.

1.3.4. AMCs to abide by the N/W requirement as per the extant MF Regulations (i.e. as applicable for MFs with active schemes), as and when the total AUM under the MF Lite Regulations, exceeds INR 1 Lakh Cr. In such instances, until the AMC meets the N/W requirement, it may not be allowed to launch any new scheme or take further subscriptions to existing schemes.

Consultation Proposal 1

Please consider the proposals at paragraphs 1.3.1 to 1.3.4 above and provide your comments separately for each of the recommendation along with the supporting rationale.

2. Shareholding and governance in Mutual Funds

2.1. The existing regulatory requirements regarding shareholding and governance in Mutual Funds including with respect to the Sponsor, Trustee and Asset Management Company (“AMC”) of a Mutual Fund, *inter-alia* state as under:

(1) A sponsor of an MF, its associate or group company including the AMC, individually or collectively, directly or indirectly, shall not have:

(a) 10% or more of the share-holding or voting rights in the AMC or the trustee company of any other mutual fund; or

(b) representation on the board of the AMC or the trustee company of any other mutual fund.

(2) Any shareholder holding 10% or more of the share-holding or voting rights in the AMC or the trustee company of a MF, shall not have, directly or indirectly,

(a) 10% or more of the share-holding or voting rights in the AMC or the trustee company of any other MF; or

(b) representation on the board of the AMC or the trustee company of any other MF.

2.2. Considering the objective of the MF Lite Regulations is to facilitate separate and relaxed requirements for the passively managed MF schemes, the manner in which the interested MFs manage passive schemes under the proposed framework, may be as under:

2.2.1. New players desirous of launching only passive MF schemes shall register under the proposed MF Lite Regulations.

2.2.2. Existing MFs having both active and passive schemes, may hive off respective passive schemes to a different group entity, thereby resulting in management of active and passive schemes by separate AMCs but under a common sponsor.

2.2.3. Existing MFs having both active and passive schemes, may hive off respective passive schemes to an unrelated entity, thereby continuing with management of only active schemes post-hive off.

2.3. The WG deliberated on the manner in which new and existing MFs may manage passive schemes under the proposed framework. Also, the WG examined the suitability of existing shareholding and governance norms for MFs under the proposed regime. The WG was of the view that the existing restriction on the shareholding of sponsor and other shareholders (i.e. with regards to 10% or more shareholding) in any other trustee/ AMC may be relaxed to the extent that the same entity may be permitted to act as a sponsor for an MF Lite mutual fund as well as for a mutual fund with only active schemes. Accordingly, WG recommended the following:

2.3.1. New players desirous of launching only passive MF schemes may register under the proposed MF Lite Regulations.

2.3.2. Existing MFs having both active and passive schemes, may hive off respective passive schemes, if they so desire, to a different group entity, thereby resulting in management of active and passive schemes by separate AMCs but under a common sponsor.

- In such cases, the sponsor may be required to completely segregate and ring-fence its resources including infrastructure, technology and staff etc. for passive MF management from the active MF management. Further, various regulatory requirements including continuous networth requirement may be made separately applicable to both AMCs (i.e. for active and passive schemes).

In such cases, the new entity, to which the passive schemes have been hived off, may be allowed to carry the past track records of such schemes.

- A sponsor may be permitted to obtain up to 2 registrations i.e. one each for MF- active and MF- Lite.

2.3.3. In case, an existing sponsor hives off passive schemes from its existing AMC to a new AMC within the same group, then the existing AMC may thereafter not be allowed to launch any passive scheme that are permitted under the proposed MF Lite Regulations.

- In such cases, an existing share holder holding 10% or more of the share-holding or voting rights in the existing AMC of an MF may be allowed to hold 10% or more of the share-holding or voting rights in the new AMC (under MF Lite) also.

2.3.4. The hive-off of the passive business by an existing AMC may be made subject to the AMC (continuing with only active schemes) providing an exit option to the existing investors of the business being hived off.

Consultation Proposal 2

Please consider the proposals at paragraphs 2.3.1 to 2.3.4 above and provide your comments separately for each of the recommendation along with the supporting rationale.

3. Role and responsibilities of trustees

3.1. The trustees of a MF hold its property in trust for benefit of the unitholders and are required to appoint an AMC to manage the funds mobilized under various

schemes of an MF, in accordance with the investment objectives and asset allocation pattern of each scheme. To achieve this, various responsibilities have been cast over a period of time, on the trustees under the MF Regulations. Also, trustees are required to employ a resource person / dedicated officer having professional qualification and experience who shall assist the trustees in discharging their various responsibilities.

- 3.2. Further, the MF Regulations restrict any person appointed as trustee of an MF to be appointed as trustee of any other MF. Also, presently an AMC or a director (including independent director), officer or employee of an AMC, cannot be appointed as a trustee of an MF.
- 3.3. Considering the increasing scale and reach of the Mutual Fund industry, the MF Regulations were amended *inter-alia* identifying certain key areas as “core responsibilities” for the trustees, which enable trustees to focus only on their fiduciary obligations and supervisory role. Accordingly, the erstwhile responsibilities of operational nature were shifted to the AMCs.
- 3.4. The said core responsibilities *inter-alia* include independent evaluation and due diligence by trustees regarding fairness of fees and expenses charged by AMCs, performance of the AMCs in its schemes *vis-à-vis* performance of peers or the appropriate benchmarks, misconduct including market abuse / misuse of information by the AMC / AMC employees / distributors, conflicts of interest between shareholders/stakeholders/associates of the AMC and unitholders, mis-selling to increase AUM and valuation of AMC etc. Further, the trustees are responsible for approval of the draft scheme offer documents prior to filing with SEBI and the appointment of directors on the Board of AMCs.
- 3.5. Considering the rule based nature of the passive funds, there is negligible discretion with AMCs regarding asset allocation, investment objective, investment related conflict of interest etc, and hence, significance of the abovementioned core areas requiring independent evaluation of trustees, gets considerably reduced for such schemes.
- 3.6. Thus, as various roles and responsibilities of trustees, as detailed under the extant regulatory framework, appear more relevant for oversight of actively managed schemes, the responsibilities for trustee of an MF Lite can be considered to be relaxed to the extent of trustees’ ensuring compliance with the regulatory provisions and protection of interest of investors. However, the role of trustees pertaining to related party transactions, conflicts of interest, undue influence of sponsor, misconduct including market abuse/ misuse of information including front running etc. would still be relevant. As an illustration, responsibilities of trustees may *inter alia* include calling for the details of transactions in securities by the key personnel of AMC in his own name or on

behalf of the AMC, quarterly reviewing all transactions carried out between the mutual funds, AMC and its associates, seeking reports from AMCs in case the AMC enters into any securities transaction with its associates, seeking details and adequate justification about the purchase and sale of the securities of the group companies of the sponsor or the AMC etc.

- 3.7. Accordingly, it is proposed that the existing roles and responsibilities of trustees pertaining to related party transactions, conflicts of interest, undue influence of sponsor, mis-selling, misconduct including market abuse/ misuse of information including front running etc. may be kept as per the existing MF Regulations.**

Consultation Proposal 3

Please consider the proposal at paragraph 3.7 above and provide your comments w.r.t whether trustees should be made responsible for all these activities pertaining to related party transactions, conflicts of interest, undue influence of sponsor, mis-selling, misconduct including market abuse/ misuse of information including front running etc. or these may be delegated to the AMCs.

- 3.8. Further, the provisions for roles and responsibilities of a trustee of the proposed MF Lite, may be as under:**

- 3.8.1. The trustee of an MF Lite shall be any entity registered under the SEBI (Debenture Trustees) Regulations, 1993 and shall satisfy the specified fit and proper criteria.**

At any given point of time, a debenture trustee may be appointed as trustee of more than one MF registered under the MF Lite Regulations. However, to avoid any possible conflicts of interest, the trustee of any MF Lite shall be an independent entity and not an associate of the sponsor(s) or manager of the concerned MF Lite.

- 3.8.2. However, in case, an existing sponsor hives off passive schemes from its existing AMC to a new AMC within the same group, the existing trustees may be appointed as trustees of the MF Lite also, if so desired by the MF Lite AMC.**

As an illustration, if existing sponsor(s) of ABC Mutual Fund decide to hive off their passive schemes to a new Lite Mutual Fund structure- i.e. ABC MF Lite within the same group, then trustee company of ABC AMC may continue to be the trustee company for

ABC MF Lite or, an independent debenture trustee may act as a trustee for ABC MF Lite, as may be decided by AMC.

- 3.8.3. To facilitate the above proposals at paras 3.8.1 and 3.8.2, the extant restriction under Regulation 7B(2) of the MF Regulations on any shareholder to hold 10% or more in trustees of more than one Mutual Fund, may be relaxed.
- 3.8.4. The trustees shall be the custodian of funds and property of the respective schemes and shall hold the same in trust for the benefit of unitholder.
- 3.8.5. The trustee shall have satisfactory wherewithal with respect to infrastructure, personnel, systems etc.
- 3.8.6. The provisions in the MF Regulations shall only lay down the principle regarding fiduciary responsibility of a trustee to ensure that the activity of MF Lite is being carried out in accordance with the applicable regulations and in the interest of the unitholders. The specific rights and responsibilities for a trustee of MF Lite and manner of oversight over AMC's activities shall be left to be mutually decided by trustee and AMCs.
- 3.8.7. Currently, the contents of trust deed are specified in Schedule 3 of MF Regulations. However, in case of the proposed MF Lite Regulations, such regulatory specification may not be necessary. AMFI in consultation with SEBI may prescribe a standard trust deed in line with roles and responsibilities of trustees elaborated at paragraph 3 and any AMC registered under MF Lite may be mandated to sign the trust deed to commence the business of managing passive funds.
- 3.8.8. The trustee shall oversee activities of the AMC in the interest of the unitholders and obtain periodic reports on its activities and status of compliance with applicable regulations.
- 3.8.9. The trustees shall have the right to seek information from the AMCs as per their trust deeds.
- 3.8.10. The trustee shall enter in to an investment management agreement with the AMC.
- 3.8.11. Where the trustees have a reason to believe that the conduct of the business of the MF is not in accordance with the MF Regulations, they shall have the right to take remedial steps, as are necessary.
- 3.8.12. The trustees shall periodically review the status of unit holders' complaints and their redressal undertaken by the AMC.
- 3.8.13. The trustee shall have the right to initiate winding up of any scheme.
- 3.8.14. The trustees shall not be held liable for acts done in good faith if they have exercised adequate due diligence and acted as per the terms of the trust deed.

- 3.8.15. The trustees shall immediately inform SEBI in case any act which is detrimental to the interest of the unitholders is noted.
- 3.8.16. The trustees may not be mandated to constitute an Audit Committee and a Risk Management Committee.
- 3.8.17. The trustees need not be required to employ any resource person/dedicated officer.
- 3.8.18. The Board of AMC's shall be appointed by the Sponsor, instead of trustee.
- 3.8.19. The trustee shall provide consent in case of change in control of AMC.
- 3.9. In case an existing AMC doesn't hive off its passive schemes and continues to manage the passive schemes under the current MF Regulations, the reduced roles and responsibilities of trustees as mentioned at paragraph 3 shall also be applicable to the existing trustees of such AMC but only pertaining to the passive funds allowed under the proposed MF Regulations.

Consultation Proposal 4

Please consider the proposal at paragraphs 3.8 and 3.9 above and provide your comments along with the supporting rationale.

4. Roles and responsibilities of Board of AMC's

- 4.1. As elaborated at para 3 above, presently, the Trustees of MFs while exercising oversight over the activities of AMC, are expected to ensure that the AMC's act in a manner which is not skewed in favour of AMC's stakeholders. While the MF Regulations over a period of time have cast various responsibilities over the Trustees, there are certain identified key areas which are to be the focus for the Trustees and can be considered as their "core responsibilities.

Further, while defining such core responsibilities of the trustees as mentioned at para 3.3 and 3.4 above, the MF Regulations were also amended to *inter-alia* enhance the accountability of the Board of an AMC including delegating of duties of operational nature to AMC's. Thus, responsibilities of Board of AMC as specified under Regulation 25 of the MF Regulations shall be applicable for Board of AMC of MF Lite also.

- 4.2. However, as the trustee for MF Lite is proposed to be an independent entity with a limited role of ensuring compliance with various regulatory requirements and protection of investors' interests, certain core responsibilities identified to be independently evaluated by trustees under the extant requirements may be shifted to the Board of AMC's of MF Lite.

4.3. Accordingly, while trustees of MF Lite shall have overarching role of protection of the interest of investors, the Board of AMC's shall have the primary accountability for acting in the interests of the investors, which may *inter-alia* include the following:

4.3.1. The following core responsibilities presently required to be independently undertaken by the trustees, may be shifted to the Board of AMC's:

- Ensuring the fairness of fees and expenses charged by the AMC's.
- Maintaining the tracking error and tracking difference within the regulatory limit.

W.r.t the other core responsibilities relating to misconduct including market abuse/ misuse by information including front running, conflict of interest, related party transaction, mis-selling etc., as mentioned at paragraph 3.4 above, the Board of AMC shall also be responsible along with the trustees.

4.3.2. Further, certain common responsibilities entrusted upon both trustees and AMC's under the extant MF Regulations, such as the following, would be applicable only to the Board of AMC's of MF Lite.

- Periodic reporting to SEBI.
- Responsibility for the overall risk management of all scheme specific and AMC specific risks, including setting up of a Risk Management Committee.
- Responsibility of filing of offer documents and obtaining regulatory approvals.
- Ensuring adequacy of infrastructure and sufficient key personnel with adequate experience and qualification to undertake management of assets at all times.
- Appointment of key personnel including the chief investment officer, registrars and share transfer agents, compliance officer, auditor, custodian etc. and empanelment of brokers.
- Responsibility for valuation of investments in accordance with the specified requirements.
- Responsibility of constitution of Unit Holders Protection Committee (UHPC)

4.3.3. Apart from the above certain reporting presently required to be made to trustees by AMC may continue for MF Lite also for information of the trustees. In case AMC fails to timely submit the same to trustee, the trustee shall intimate regarding the same to SEBI. Such information *inter-alia* may include the following:

- Information sharing of TE (In case of equity) and TD (in case of debt) in case it exceeds specified limits.
- Submission of declaration on votes casted by AMC that votes are cast in best interest of investors.
- Sharing of information regarding breakage of seal and/or breakdown of the time stamping process.
- Sharing of information of change in TER.
- Information on declaration of record date, determination of quantum of dividend to be paid. Ratification of actual dividend paid.

In case the trustees find any adverse observations with respect to the aforesaid reporting, the trustee shall intimate regarding the same to SEBI.

4.3.4. As regards the role of trustees pertaining to related party transactions, conflicts of interest, undue influence of sponsor, mis selling, misconduct including market abuse/ misuse of information; including front running etc. which is proposed to be retained as per the extant framework, the trustees shall seek information from AMCs pertaining to the aforesaid issues. In case of any adverse observations with respect to the same, the trustee shall intimate SEBI regarding the same.

4.3.5. Also, the trustees are presently required to grant following approvals, which may be accorded by Board of AMC under the MF Lite framework:

- Approval for parking of funds pending deployment, in case it exceeds specified limit.
- Approval for a detailed written policy on creation of segregated portfolio (in case of debt oriented mutual funds) and necessary monitoring of recovery of investment proceeds.

Consultation Proposal 5

Please consider the proposal at paragraph 4.3 above and provide your comments along with the supporting rationale.

5. Restrictions on business activities of AMCs

5.1. As per Regulation 24(b) of the existing MF Regulations, an AMC is *inter-alia* restricted from carrying out business activities other than in the nature of management and advisory services provided to pooled assets including offshore funds, insurance funds, pension funds, provident funds, foreign

portfolio investors etc. and Portfolio Management services, if any of such activities are not in conflict with the activities of the Mutual Fund and subject to specified conditions.

- 5.2. The WG noted that as the regulatory requirements (including lower N/W requirement) for the entities registered under MF Lite Regulations are proposed to be lighter as compared to the same for the existing AMCs, the arena of activities to be allowed under MF Lite Regulations may also be restricted to managing passive MF schemes only. **Accordingly, the entities registered under MF Lite may not be allowed to do any business activity other than managing passive MF schemes.**

Consultation Proposal 6

Please consider the proposal at paragraph 5.2 above and provide your comments along with the supporting rationale.

6. Investment Management Agreement

- 6.1. Under the present regulatory framework, the trustees and AMC are required to enter in to an investment management agreement as per the contents specified therein.
- 6.2. **It is proposed that the details of the investment management agreement in respect of MF Lite framework, shall be specified by AMFI, in consultation with SEBI.**

Consultation Proposal 7

Please consider the proposal at paragraph 6.2 above and provide your comments along with the supporting rationale.

7. Advertisement Code

- 7.1. The Sixth Schedule of the MF Regulations prescribes detailed advertisement code to be followed by AMCs.
- 7.2. As per the existing MF Regulations, all scheme related expenses are required to be paid within the regulatory limits necessarily from the scheme only and not from the books of the AMC. The same provision shall be applicable for MF Lite also. Further, the TER charged by the passive schemes across industry is generally around 20 bps, which is significantly lower as compared to the TER charged by actively managed MF schemes. Therefore, the scope of

bearing higher advertisement cost within TER by passive schemes is significantly less, as compared to active schemes.

- 7.3. Moreover, as passive schemes are rule based by nature, scope of mis-selling of passive schemes, is low. Therefore, with a limited cost, such MFs running only passive schemes shall only be able to come up with simpler advertisements, if they so desire. Hence, detailed advertisement code as in the existing MF Regulation may not be required.
- 7.4. In view of the above, it is proposed that elaborated content of the advertisement code may not be necessary and it may be sufficient to mandate that any advertisement of passive investment schemes shall not be misleading or lead to mis-selling of such schemes. Further, any advertisement by passive schemes shall be in accordance with the offer documents and any circulars or guidelines specified by SEBI in this regard.

Consultation Proposal 8

Please consider the proposal at paragraph 7.4 above and provide your comments along with the supporting rationale.

8. Risk Management Committee (RMC) for oversight of risk at AMC level.

- 8.1. As per the extant risk management framework of MFs, both the AMC and the trustees are mandatorily required to have separate RMCs. The RMCs *inter-alia* undertake annual review of risk management framework at both AMC and scheme level and recommend long term solutions regarding risk management at both AMC and scheme level. The CRO of the MF has to be part of both RMCs, which reports to Board of AMCs and trustees.
- 8.2. The WG noted that as there are lesser risks associated with passive schemes especially, market risks and investment risks, the role of RMCs may be limited in case of passive funds and adds to the cost of compliance. It was thus discussed that the responsibilities of RMC can be additionally carried out by the Audit Committees.
- 8.3. As regards trustees, it is already proposed at para 3.8.16 that requirement of Audit Committee and RMC at the trustee level may not be applicable. Further, it is proposed that the requirement of RMC at AMC level may be made optional and the Audit Committees of AMCs may undertake the additional role of RMCs in case of MF Lite.

Consultation Proposal 9

Please consider the proposal at paragraph 8.3 above and provide your comments along with the supporting rationale.

9. Transactions through associated broker

9.1. As per the existing regulatory provisions,

- An AMC shall not through any broker associated with the sponsor, purchase or sell securities, which is average of 5% or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes:
 - The aggregate purchase and sale of securities shall exclude sale and distribution of units issued by the mutual fund:
 - The aforesaid limit of 5 per cent shall apply for a block of any 3 months.

- An AMC shall not purchase or sell securities through any broker (other than the associated broker) with average of 5 per cent or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes, unless the AMC has recorded in writing the justification for exceeding the limit and reports of all such investments are sent to the trustees on a quarterly basis. The aforesaid limit shall apply for a block of three months.

9.2. The WG deliberated that as the brokerages earned in case of passive funds are substantially lower than that earned from transactions in active schemes, the brokers may be less incentivized to undertake purchase, sale and market-making in case of the passive schemes. Thus, a broker needs economies of scale in terms of volume to commit to the development of passive funds.

9.3. It was also noted that presently there are very few brokers as market-makers with adequate systems to implement the basket execution of ETFs. In view of the above, an AMC intending to launch only passive schemes under MF Lite, may need large number of brokers to carry out the purchase, sale and market making of underlying securities which may be challenging for such AMCs.

9.4. It is thus proposed that the current limit of 5% at the AMC level for purchase or sell of securities through an associate broker may be extended to 10% in case of associated broker and to 25% in case of a non-associate broker, for all entities under the MF Lite Regulations.

Consultation Proposal 10

Please consider the proposal at paragraph 9.4 above and provide your comments along with the supporting rationale.

10. Simplified Scheme Information Document (Simplified SID)

- 10.1.** As per SEBI Circular dated November 01, 2023 on “Simplification and streamlining of offer document of Mutual Fund schemes”, the format for filing of SID has been simplified for all schemes. Considering the limited risks associated with passively managed schemes, the format for draft SID for passive schemes is proposed to be further simplified. The proposed format of the SID is attached at **Annexure A**.
- 10.2.** Further, currently, there are two types of processes for registration of domestic passive MF schemes and Fund of funds with single underlying ETF as an underlying fund, i.e. (i) Normal Registration and (ii) Fast Track of Registration granted based on an undertaking by CEO taking responsibility for acts of omission or commission.
- 10.3.** It is proposed that fast tracking of SIDs (currently optional) shall be made mandatory for passive schemes floated by such AMC registered under MF Lite Regulations.
- 10.4.** The proposed modifications *vis-à-vis* the current prescribed format of SID *inter-alia* include the following:
- 10.4.1.** Parameters such as investment strategy, instruments in which schemes shall invest, performance of the scheme benchmark etc., which are not relevant in case of passive schemes and applicable only in case of active schemes, shall be removed from the SID.
- 10.4.2.** The important parameters related to passive schemes such as tracking error, tracking difference, name of the underlying benchmark, specific attributes of target maturity debt passive schemes such as lock in period, maturity of the target duration fund etc., which are important parameters to be understood by an investor, shall be incorporated in the SID in the “Highlight Section”.
- 10.4.3.** The disclosure of other parameters such as NAV, risk factors, portfolio disclosure, scheme specific disclosure etc. shall be facilitated with a web link of the AMC website in the SID.
- 10.4.4.** The requirement of separate filing of the Key Information Memorandum (KIM) shall be relaxed.

Consultation Proposal 11

Please refer the format of the draft SID at Annexure A of this consultation paper and provide your comments along with the supporting rationale.

11. Submission of trustee report to SEBI

11.1. As per the existing MF Regulations, the trustees are required to submit Half Yearly Trustee Report (HYTR) to SEBI in a specific format.

11.2. In this regard, it is proposed that submission of trustee report to SEBI may be discontinued considering the limited role of trustees in case of MF Lite. However, since Board of AMC shall have the primary accountability of acting in the interests of the investors, the Board of AMC may be required to submit Yearly AMC Report (YAR) in case of MF Lite.

Consultation Proposal 12

Please consider the proposal at paragraph 11.2 above and provide your comments along with the supporting rationale.

Section II

Section II of this consultation paper deals with the proposals pertaining to ease of compliance, relaxed disclosures and other regulatory requirements for passive schemes under existing MFs as well as schemes that may be launched under the MF Lite registration. This will ensure uniform applicability of the proposed MF Lite Regulation and provide a level playing field across the passive MF industry.

12. Investor education and awareness

12.1. The Mutual Funds/AMCs are currently required to annually set apart a minimum percentage of every scheme's daily net assets, within the overall base TER, for investor education and awareness initiatives. Further, all AMCs are required to transfer half of such amount set aside w.r.t their schemes to AMFI, for investor awareness at an industry level.

12.2. In this regard, the AMCs are required to set apart 1 bps of daily net assets for ETFs / Index Funds, within the maximum limit of TER for such funds. As regards the Fund of Funds (FoFs) investing more than 80% of their NAV in the underlying domestic funds, there is no such requirement.

12.3. The WG noted that considering the limited spread available in charging of TER in passive funds, the requirement for setting aside for investor education and awareness may be relaxed for MF Lite. **Accordingly, it is proposed that the provisions regarding allocating funds towards investor education and awareness initiatives for passive schemes and Fund of funds, may be as under:**

a. Domestic Fund of Funds (investing more than 80% of NAV in domestic passive fund – Nil

b. ETFs/Index Funds/Overseas Fund of Funds (FoFs) investing in underlying ETFs –

- For total AUM up to INR 250 Cr. – Nil
- For total AUM beyond INR 250 Cr. – 5% of TER charged to direct plans, subject to maximum of 0.5 bps of AUM.

12.4. With respect to half of the amount set apart for investor education which is transferred to AMFI by all MFs, it was observed by the WG as under:

- Currently the corpus allocated towards investor education and awareness is dedicated towards the MF industry as a whole.
- The AUM of passive funds represents almost 1/6th of overall AUM of Mutual Fund industry as on April 30, 2024, however there is no specified provision for allocation of the aforesaid corpus for active and passive funds separately.

- Looking at the significant expansion during recent years and growth potential of passive funds, it is crucial to allocate resources towards education and creating awareness among investors about the benefit of passive investment strategies.

12.5. Hence, it is proposed that out of the total amount transferred to AMFI for investor awareness by AMCs, AMFI shall allocate a minimum of 5 percent for focused investor education and awareness towards promoting passive funds, distinct from AMFI's general investor education initiatives.

Consultation Proposal 13

Please consider the proposals at paragraphs 12.3 and 12.5 above and provide your comments along with the supporting rationale.

13. Introduction of Hybrid ETFs/ Index Funds

13.1. The WG discussed that the regulatory provision, currently, provide for passive funds to replicate only a debt index or an equity index, with no framework available for a passive fund to replicate a hybrid index i.e a composite construct of a debt and equity index. It was felt that inclusion of the same may provide further flexibility and diversification opportunities in passive MF segment.

13.2. It is thus proposed to introduce Hybrid passive funds which shall replicate a composite index comprising fixed proportions of equity and debt and enable investors to invest in a single product having exposure to both equity and debt instruments. The proposed framework for hybrid passive schemes is as under:

13.2.1. Hybrid ETF / Index Fund shall mean an ETF / Index Fund which tracks an index containing a combination of constituents of domestic equity and debt indices.

13.2.2. To begin with, only 3 sets of hybrid passive schemes shall be permitted with the following features:

Sr. No.	Categories of Hybrid Passive Schemes	Asset Allocation of Benchmark Index
1	Debt oriented	Equity: Debt – 25:75
2	Balanced	Equity: Debt- 50:50
3	Equity oriented	Equity: Debt- 75:25

13.2.3. A MF shall launch maximum 1 scheme per aforesaid category of hybrid funds.

- 13.2.4. The minimum subscription amount at the time of New Fund Offer (NFO) for Hybrid ETFs/ Index Funds shall be INR 10 Crore.
- 13.2.5. The ETF/ Index Fund issuer shall evaluate and ensure compliance of the asset allocation of equity and debt for all its Hybrid ETFs/ Index Funds, at the end of every calendar quarter.
- 13.2.6. The provisions regarding composition of indices for debt ETFs / Index Funds as specified in paragraph 3.5 of the Master Circular for Mutual Funds, shall apply to the debt component of Hybrid ETFs / Index Funds also. Further, debt indices for this purpose shall be only constant duration indices which shall be specified by AMFI, in consultation with SEBI. (Kindly refer paragraph 18 below).
- 13.2.7. The provisions regarding composition of indices for Equity ETFs / Index Funds under paragraph 3.4 of the Master Circular for Mutual Funds shall apply to the Equity Index component of Hybrid ETFs / Index Funds. The equity indices shall be only broad based indices based on one of the indices comprising of equity shares from top 250 companies in terms of market capitalization and from the list of indices which shall be specified by AMFI, in consultation with SEBI. (Kindly refer paragraph 18 at succeeding pages).
- 13.2.8. The provisions regarding replication and rebalancing norms as specified in paragraphs 3.5 and 3.6.7 of the Master Circular for Mutual Funds for ETF / Index Funds shall apply as per the existing norms for debt and equity components of Hybrid ETF /Index Funds, respectively.
- 13.2.9. Hybrid ETFs / Index Funds shall disclose the tracking error (TE) and tracking difference (TD) for both equity and debt components of the portfolio and the underlying index. Further, the TD for such funds shall be targeted to be less than 1.25%.

Note: In case of Hybrid passive funds, where 100% replication of underlying debt constituents is not envisaged, targeted TD as applicable on debt ETF/Index funds is proposed.

- 13.2.10. Sectoral / Thematic funds and Target Maturity Funds shall not be allowed for the equity and debt components respectively, of the Hybrid passive funds.

13.2.11. Hybrid ETFs may disclose the indicative NAV (iNAV) at least four times a day i.e., opening and closing iNAV and at least two times during the intervening period with minimum time lag of 90 minutes between the two disclosures.

Consultation Proposal 14

Please consider the proposals at paragraph 13.2 above and provide your comments along with the supporting rationale.

14. Investment and trading in securities by the employees of the AMC(s) and Trustee(s)

14.1. Currently, various approvals and reporting requirements are mandated prior to any investment and/or for trading in securities by the employees of the AMCs and trustees.

14.2. The WG noted that considering negligible scope for active management of funds in passive schemes, prior approval of employees' transactions may be replaced with prior intimation. **Thus, it is proposed that the prior intimation of at least 3 working days before the date of transaction shall be mandated. Further, the requirement for reporting of employees' transactions within 7 working days shall be retained.**

Consultation Proposal 15

Please consider the proposal at paragraph 14.2 above and provide your comments along with the supporting rationale.

15. Compliance and disclosure

15.1. Updation of SID & KIM

As per current provisions, SIDs are required to be updated within next six months from the end of the 1st and 2nd halves of the financial year in which the schemes were launched, based on the relevant data and information as at the end of previous month. Further, SID needs to be updated within one month from the end of the half-year, based on the relevant data and information as at the end of September and March months respectively.

It is proposed that SID for passive schemes may be updated within 2 months from the end of the financial year.

15.2. Portfolio Disclosure

The WG discussed that the current provisions for MF portfolio disclosure are as under:

- For debt schemes- on a fortnightly basis within 5 days of every fortnight
- For other schemes: on a monthly basis within 10 working days of each month.
- For all schemes- on a half yearly basis within 10 working days of the end of the half year

It is proposed that the portfolio disclosure norms for passive funds shall be relaxed as under:

- **Debt and hybrid passive schemes: monthly basis within 10 days of every month**
- **Equity Passive schemes: within 10 days from the close of each quarter**
- **Separate disclosure on a half yearly basis may be done away for passive funds with as the same is already incorporated in the monthly and quarterly disclosure of Debt (& hybrid) and equity passive schemes.**

15.3. Unaudited Half Yearly Financials

As per the existing MF Regulations, the publication of the unaudited half-yearly results is required to be made on the website of MF before the expiry of one month before the close of each half year.

Considering that the passive schemes aims to replicate the returns of underlying index or benchmark, it is proposed that the requirement for publishing unaudited half yearly financials shall be discontinued. However, annual report of the schemes under MF Lite shall continue to provide such details.

Consultation Proposal 16

Please consider the proposals at paragraphs 15.1, 15.2 and 15.3 above and provide your comments separately along with the supporting rationale.

16. Investments by passive schemes

16.1. Currently, AMCs are allowed to launch equity and debt oriented passive schemes based on equity and debt indices only. Further, AMCs can manage commodity based ETFs based on only gold and silver commodities. As per paragraph 2.6 of the Master Circular on mutual funds regarding “Categorization

and Rationalization of Mutual Fund Schemes”, passive schemes are mandated to invest minimum 95% of the total assets in securities of the underlying index.

16.2. It was deliberated by WG that considering the simpler operations of passive schemes, underlying securities in which they invest may be equity, plain vanilla debt securities, physical commodities and exchange traded commodity derivatives. Further, the WG was of the view that investment in equity derivatives of underlying securities forming part of the index may also be available as an investment option in case the underlying security is not available for purchase. However, investments in bespoke debt securities and debt derivatives may not be allowed.

16.3. The provisions related to Interval schemes, Capital Protection oriented schemes, Real Estate MF schemes and Infrastructure Debt Fund Schemes may not be relevant under the MF Lite regime and hence, may not be applicable. Similarly, provisions such as stress testing for debt funds and liquidity risk management framework for debt funds may continue to not be applicable for passive funds, as is the case at present.

16.4. Further, it is proposed that passive schemes may not be allowed to invest in the following:

- Unlisted debt instrument
- Bespoke or complex debt products
- Securities with special features
- Inter scheme transactions
- Short selling
- Derivatives (except for portfolio rebalancing)
- Unrated debt and money market instruments (except Gsecs, Tbills and other money market instruments)

Consultation Proposal 17

Please consider the proposals at paragraphs 16.2, 16.3 and 16.4 above and provide your comments separately along with the supporting rationale.

17. Other proposals

17.1. Tracking difference for equity oriented passive schemes

17.1.1. As per the current regulatory provisions, TE for equity passive funds is required to be below 2% and TD has to be disclosed. For debt passive funds, TD has to be below 1.25% and TE has to be disclosed.

- 17.1.2. Currently, there is no regulatory requirement for maintaining TD in case of equity passive schemes. In this respect, it is proposed that TD may be mandated for the equity passive schemes also. Although the maximum TER allowed for the passive funds is 1%, average TER in such schemes is generally much lower. Accordingly, it is proposed that for equity ETFs/Index funds, TD may be targeted to be lower of 1.5 times of TER charged or 1.25%.

Consultation Proposal 18

Please consider the proposal at paragraph 17.1.2 above and provide your comments separately along with the supporting rationale.

17.2. Disclosure of “Debt Index Replication Factor (DIRF)” in debt oriented passive schemes

- 17.2.1. Paragraph 3.6 of the Master Circular for mutual funds on “development of passive funds” *inter alia* includes regulatory provisions for constitution of index and norms for construction of portfolio for debt oriented passive schemes.
- 17.2.2. As per the aforesaid provisions, corporate debt ETFs/ Index funds comprising of only corporate debt securities are considered to be replicating the underlying debt index provided Investment in securities of issuers accounting for at least 60% of weight in the index, represents at least 80% of net asset value (NAV) of the ETF/ Index Fund subject to certain relaxations in duration and rating. Similarly, debt ETFs/ Index Funds based on G-sec, T-bills and SDLs are also considered to be replicating the underlying index subject to certain relaxation in the duration of the portfolio w.r.t its benchmark. Therefore, the debt oriented passive schemes are not required to fully replicate the underlying index.
- 17.2.3. In this regard, it is proposed that debt oriented passive schemes may also be mandated to disclose the “Debt Index Replication Factor (DIRF)” of the underlying index by the portfolio along with the TE and TD on their AMC’s website. For this purpose, 100% replication at individual issuer level shall be achieved if the portfolio has same issuer in the exact same percentage as is the case for the Index. In case the weightage of a particular issuer is different in the Index and the portfolio, then lesser of the weightage (subject to assigning 0 replication percentage where the instrument is absent in either index or portfolio) would be considered as replicated (“Individual issuer Replication Factor”) and the aggregate of all such

replication factors in the portfolio would give portfolio level replication or DIRR. An illustration is provided below:

Instrument	Index weight	Portfolio weight	Replication Factor
A	15%	13%	13%
B	13%	15%	13%
C	8%	8%	8%
D	12%	0%	0%
E	0%	12%	0%
F	0%	8%	0%
G – AAA	8%	0%	0%
G-Sec/ T-bills	22%	20%	20%
SDLs	13%	16%	13%
Cash and Cash Equivalents	9%	8%	8%
Total	100%	100%	75%

Consultation Proposal 19

Please consider the proposal at paragraph 17.2.3 above and provide your comments separately along with the supporting rationale.

17.3. Uniform guidelines for launching equity passive schemes for overseas indices

17.3.1. In the current regulatory regime, concentration norms for underlying index have been specified for equity ETFs and Index funds. Although the said concentration norms are applicable for the overseas indices also, the construction of overseas indices may vary w.r.t selection of stocks of different countries, liquidity in the stocks of different countries, impact cost of the underlying stocks etc.

Unlike domestic securities, the availability of information w.r.t liquidity, impact cost etc. of the underlying securities of the overseas indices may also pose challenge.

17.3.2. In this regard, it is proposed that a uniform approach may be applied to standardize the overseas indices on which ETFs or FoF may be launched. In view of the above, the following framework is proposed:

17.3.2.1. The indices, on which overseas passive schemes are to be launched, shall be standardized across industry and broad based. AMC's may be allowed to launch overseas passive schemes only on such indices as may be prescribed by AMFI, in consultation with SEBI.

17.3.2.2. Overseas ETFs/Index funds and FoFs investing in overseas ETF/index shall comply with the diversification requirement of minimum 10 securities in an equity index portfolio.

17.3.2.3. Overseas passive schemes shall comply with Undertakings for the Collective Investment in Transferable Securities (UCITS) guidelines of 5/10/40 criteria, which states that no single asset shall represent more than 10% of the index and constituent holding of more than 5% cannot in aggregate exceed 40% of the index.

17.3.2.4. In addition to the above, certain widely known and tracked Overseas indices of the leading Index providers /Stock exchanges shall also be allowed.

17.3.3. Notwithstanding paragraph 17.3.2.3 and 17.3.2.4 above, the permissible overseas indices, under the proposed MF Lite Regulation, shall be subject to a threshold based on a minimum global AUM following such indices as may be specified by SEBI.

Consultation Proposal 20

Please consider the proposal at paragraph 17.3 above and provide your comments separately along with the supporting rationale.

Further, indicate whether a threshold of global AUM should be provided. If yes, please indicate the threshold along with supporting rationale.

17.4. Introduction of close ended debt passive schemes.

17.4.1. Currently there are target maturity debt passive schemes in existence, wherein the index of the scheme matures on a particular date and after that the fund also expires. Further, such schemes are open ended as the investors may subscribe or redeem any time during the life of the fund.

17.4.2. In this respect, it is proposed that an option for launching of close ended debt passive scheme may be enabled.

Consultation Proposal 21

Please consider the proposal at paragraph 17.4.2 above and provide your comments separately along with the supporting rationale.

18. Categories of schemes under MF Lite Regulations

18.1. The WG discussed that as the MF Lite regime is intended to be lighter than current regulatory framework for MFs, the domain of passive schemes to be allowed under MF Lite Regulations needs to be carefully considered. Accordingly, the WG considered different types of passive schemes (and underlying indices) which should be allowed under relaxed regime. Pursuant to detailed deliberations, the WG was of the view that there can be two approaches towards allowing the passive schemes to be launched under the MF Lite Regulations. The two approaches are proposed as under:

Approach 1

- **This approach shall be implemented in a phased manner. Under phase 1, a list shall be prescribed by SEBI constituting only those domestic equity passive indices (broad indices tracked by passive funds or act as primary benchmark for actively managed funds), whose quantitative threshold/ AUM exceeds a minimum threshold of either INR 10,000 Cr. or INR 5,000 Cr. or with no threshold.**

Further, overseas indices to be permitted under paragraph 17.3 above may also be permitted in phase 1 of implementation of MF Lite regime. Schemes based on other indices may be considered to be allowed in phase 2 of implementation.

- **As regards debt passive schemes, only those target maturity and target duration debt passive schemes may be considered in phase 1 of implementation of MF Lite regime, which comply with the underlying principle that the constituents of the reference benchmark of such debt passive schemes should not change, other than in case of periodic rebalancing criteria based on simple parameters such as duration.**

The aforesaid list of equity and debt indices may be prescribed by AMFI, in consultation with SEBI.

Adopting approach 1 shall ensure that only passive schemes based on broad indices are initially launched by new players in the MF Lite regime, which shall prevent proliferation of indices/ schemes and encourage only serious players to be registered under the proposed MF Lite Regulations.

However, if approach 1 is followed, the proposed MF Lite Regulation shall be applicable only to a limited set of passive schemes. Thus, while schemes

permitted under phase 1 shall be covered under the relaxed MF Lite Regulations, remaining existing passive schemes under existing MFs shall be governed under the existing MF Regulations.

Further, in case of the existing mutual funds registered under the existing MF Regulations, all the proposals mentioned at Section 2 of this consultation paper pertaining to ease of compliance, relaxed disclosures and other regulatory provisions shall be applicable only to limited sets of passive schemes based on the indices permitted under this approach.

Approach 2

- **There may not be a phased implementation and all existing ETFs, Index funds, domestic and overseas FoFs investing in a single ETF/Index fund may be included under MF Lite regime.**
- **Further, for any new equity passive scheme with underlying index other than those with existing passive schemes, they may be launched subject to list of such indices prescribed by AMFI, in consultation with SEBI.**
- **For debt passive schemes, the existing requirement for AMFI to prescribe list of indices, *inter-alia* specified in paragraph 3.5.2.11 of the Master Circular on Mutual Funds, shall apply.**

Going for approach 2 shall ensure uniform applicability of Regulations across passive MF industry as well as offer diversified investment opportunities with adequate flexibility for both investors and MFs.

Consultation Proposal 22

- ***Please consider Approaches 1 and 2 at paragraph 18.1 above and provide your comments separately with supporting rationale.***
- ***In respect of Approach 1, for domestic equity indices - whether an AUM threshold of minimum INR 10,000 Cr. or INR 5,000 Cr. would be appropriate OR no threshold should be provided.***

Consultation Proposal 23

Please provide your comments with supporting rationale w.r.t selection of debt indices to be considered under the proposed MF Lite Regulation.

D. Public Comments

I. Public comments are invited for the proposals at paragraph C(1)- C(18) above. The comments/ suggestions should be submitted by any of the following modes latest by July 22, 2024:-

- **Online web-based form**

a) The comments may be submitted through the following link:
<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

b) The instructions to submit comments on the consultation paper are as under:

- Before initiating the process, please read the instructions given on top left of the web form as “Instructions”.
- Select the consultation paper you want to comment upon from the dropdown under the tab – “Consultation Paper” after entering the requisite information in the form.
- All fields in the form are mandatory;
- Email Id and phone number cannot be used more than once for providing comments on a particular consultation paper.
- If you represent any organization other than the types mentioned under dropdown in “Organization Type”, please select “Others” and mention the type, which suits you best. Similarly, if you do not represent any organization, you may select “Others” and mention “Not Applicable” in the text box.
- There will be a dropdown of Proposals in the form. Please select the proposals one- by-one and for each of the proposal, please record your level of agreement with the selected proposal. Please note that submission of agreement level is mandatory.
- If you want to provide your comments for the selected proposal, please select “Yes” from the dropdown under “Do you want to comment on the proposal” and use the text boxes provided for the same.
- After recording your response to the proposal, click on “Submit” button. System will save your response to the selected proposal and prompt you to record your response for the next proposal. Please follow this procedure for all the proposals given in the dropdown.

- ix. If you do not want to react on any proposal, please select that proposal from the dropdown and click on “Skip this proposal” and move to the next proposal.
 - x. After recording your response to all the proposals, you may see your draft response to all of proposals by clicking on “Check your response before submitting” just before submitting response to the last proposal in the dropdown. A pdf copy of the response can also be downloaded from the link given in right bottom of the web page.
 - xi. The final comments shall be submitted only after recording your response on all of the proposals in the consultation paper.
- c) In case of any technical issue in submitting your comments through web based public comments form, you may contact the following through email with a subject “Consultation Paper for introduction of Mutual Funds Lite Regulations (MF LITE) for passively managed Mutual Funds Schemes”.
- i. Mr. Lakshaya Chawla, Deputy General Manger(lakshayac@sebi.gov.in)
 - ii. Mr. Bimal Prasad Panda, Manager (bimalp@sebi.gov.in)
 - iii. Ms. Kritika, Assistant Manager (kritika@sebi.gov.in)

Issued on: July 01, 2024

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(End of Consultation Paper)

Annexure A

SCHEME INFORMATION DOCUMENT

Applicable for Schemes under proposed MF Lite structure

Name of Mutual Fund :
 Name of Asset Management Company :
 Address of AMC :
 Website of AMC :
 Name of Trustee Company :
 Address of Trustee Company :
 Name of the Scheme :
 Category of Scheme : Equity/ Debt/ Hybrid ETF/ Index Fund or Fund of Funds.

In case of Hybrid funds, indicate the sub category
 (Conservative/ Aggressive/ Balanced)

Scheme Code: (To be disclosed after obtaining the same):

NFO open date:

NFO close date:

Offer for Units of Rs. -- each for cash during the New Fund Offer and Continuous offer for Units at NAV based prices

Investment objective	Scheme Riskometer	Benchmark Riskometer (as applicable)
Passive investment in equity and equity related securities replicating the composition of the Index, subject to tracking errors "There is no assurance that the investment objective of the Scheme will be achieved"		

Investors are advised to refer to the Statement of Additional Information (SAI) for details of the _____ Mutual Fund, Standard Risk Factors, Special Considerations, Tax and Legal issues and other general information on www._____.

The particulars of the Scheme have been prepared in accordance with the Securities and Exchange Board of India (Mutual Funds) Regulations 1996, (herein after referred to as SEBI (MF) Regulations) as amended till date and circulars issued thereunder filed with SEBI. The units being offered for public subscription have not been approved or recommended by SEBI nor has SEBI certified the accuracy or adequacy of the Scheme Information Document.

The Scheme Information Document sets forth concisely the information about the scheme that a prospective investor ought to know before investing. Before investing, investors should also ascertain about any further changes to this Scheme Information Document after the date of this Document from the Mutual Fund / Investor Service Centres / Website / Distributors or Brokers.

SAI is incorporated by reference (is legally a part of the Scheme Information Document). For a free copy of the current SAI, please contact your nearest Investor Service Centre or log on to our website.

The Scheme Information Document should be read in conjunction with the SAI and not in isolation.

This Scheme Information Document is dated _____.

HIGHLIGHTS/SUMMARY OF THE SCHEME

Sr. No.	Title	Description				
I.	Benchmark (TRI)					
II.	Plans and Options Plans/Options and sub options under the Scheme	<p>Plan- Direct Plan/Regular Plan Options under each Plan(s)</p> <p>Growth Income Distribution cum Capital Withdrawal (IDCW) (include facilities if applicable)</p> <ul style="list-style-type: none"> • Including Default option/ facility (as applicable) <p>For detailed disclosure on default plans and options, kindly refer SAI.</p>				
III.	TER applicable	(Mention only the maximum permissible % that can be charged)				
IV.	Load Structure	Exit Load:				
V.	Minimum Application Amount/switch in	<ul style="list-style-type: none"> • During NFO: • On continuous basis: <p>For detailed disclosure, kindly refer SAI</p>				
VI.	Minimum Additional Purchase Amount	<ul style="list-style-type: none"> • On continuous basis: <p>For detailed disclosure, kindly refer SAI</p>				
VII.	Minimum Redemption/switch out amount	<ul style="list-style-type: none"> • On continuous basis: <p>For detailed disclosure, kindly refer SAI</p>				
VIII.	Tracking Error	<table border="1"> <tr> <td>Regular Plan</td> <td>Direct Plan</td> </tr> <tr> <td></td> <td></td> </tr> </table>	Regular Plan	Direct Plan		
Regular Plan	Direct Plan					
IX.	Tracking Difference	<table border="1"> <tr> <td>Regular Plan</td> <td>Direct Plan</td> </tr> <tr> <td></td> <td></td> </tr> </table>	Regular Plan	Direct Plan		
Regular Plan	Direct Plan					

X.	Computation Of NAV	Mention the formula for computation of NAV
XI.	Asset Allocation.	<p>This scheme tracks Index.</p> <p>95% allocation is to the constituents of index and 5% to (as applicable)</p> <p>For details refer Annexure A1 (As applicable)</p>
XII.	Fund manager details	<p>Name:</p> <p>Managing since:</p> <p>Total experience (in years)</p>
XIII.	Annual Scheme Recurring Expenses	(Mention only the actual TER charged)
XIV.	Transaction charges and stamp duty	Indicate only the amount of transaction charges and stamp duty applicable
XV.	Information available through weblink	<p>(Following information may be provided through weblink. Mention weblink/ weblinks in this box for each item)</p> <ul style="list-style-type: none"> • <i>Liquidity/listing details</i> • NAV disclosure • Applicable timelines for dispatch of redemption proceeds etc • Breakup of Annual Scheme Recurring expenses • Definitions • Applicable risk factors • Detailed disclosures regarding the index, index eligibility criteria, methodology, index service provider, index constituents, impact cost of the constituents/ underlying fund in case of fund of funds • List of official points of acceptance • Penalties, Pending Litigation or Proceedings, Findings of Inspections or Investigations • Investor services • Portfolio Disclosure • Detailed comparative table of the existing schemes of AMC • Scheme performance • Periodic Disclosures • Any disclosure in terms of Consolidated Checklist on Standard Observations • Scheme specific disclosures (as per the prescribed format) <p><i>Instruction to AMC : For details on disclosures to be provided under each of the above bullet points, refer to Annexure A2 titled 'Sections moved to Weblink')</i></p>

	How to Apply	Summary of process only like availability of application form from either the Investor Service Centers (ISCs)/Official Points of Acceptance (OPAs) of AMC or may be downloaded from the website of AMC. For detailed disclosure, kindly refer SAI
	Where can applications for subscription/redemption/switches be submitted	Summary of process only like the list of official points of acceptance, collecting banker details etc. Inform investors that it is mandatory to mention their bank account numbers in their applications/requests for redemption For detailed disclosure, kindly refer SAI
	Specific attribute of the scheme (such as lock in/ duration in case of target maturity scheme/close ended schemes etc.) (as applicable)	
	Special product/facility available during the NFO and on ongoing basis	Briefly describe the facilities/products Available Facilities like: <ul style="list-style-type: none"> • Systematic Investment Plan • Systematic Transfer Plan • Systematic Withdrawal Plan • For further details of above special products / facilities, For detailed disclosure, kindly refer SAI

Optional

	Segregated portfolio/side pocketing	Optional. Confirmation/disclosure statement only. For Details, kindly refer SAI
	Stock lending	Confirmation/disclosure statement only. For Details, kindly refer SAI

Annexure A1:

AMC to choose the applicable provisions based on intended asset allocation	
Equity derivatives of underlying securities forming part of the index may also be available as an investment option in case the underlying security is not available for purchase.	<ul style="list-style-type: none"> • Calculation of cumulative gross exposure • Numerical example of risk involved • Disclosure relating to extent and manner of participation in derivatives to be provided
ETCDs (applicable to ETFs only)	<ul style="list-style-type: none"> • Risk factors w.r.t ETCDs • Calculation of cumulative gross exposure • Investment limits • Disclosure relating to extent and manner of participation in derivatives to be provided
Hybrid schemes	As applicable
Close ended debt schemes	As applicable

Annexure A2- Sections moved to Weblink:

<i>Liquidity/listing details</i>	Provide Liquidity provisions on ongoing basis. Listing details only to be provided if the scheme intends to list immediately after NFO.
NAV disclosure	<ul style="list-style-type: none"> • Disclosure timings • Disclosure pertaining to illustration on computation of NAV and Methodology for calculation of sale and re-purchase price of the units of mutual fund scheme.
Applicable timelines	Timeline for <ul style="list-style-type: none"> • Dispatch of redemption proceeds, • Dispatch of IDCW (if applicable) etc.
Breakup of Annual Scheme Recurring expenses	<ul style="list-style-type: none"> • Head wise breakup including impact of TER on returns of both directs and regular plan through illustration may be provided. • TER for last 6 months as well as scheme factsheet shall be made available
Definitions	<i>Functional website link that contains detailed description</i>
Risk factors	<ul style="list-style-type: none"> • Scheme specific risk factors • Risk mitigation strategies
Index methodology/ Details of underlying fund in case of Fund of Funds	Disclosures regarding the index, index eligibility criteria, methodology, index service provider, index constituents, impact cost of the constituents. In case of Fund of Funds Scheme, Details of Benchmark, Investment Objective, Investment Strategy, TER, AUM, Year wise performance, Top 10 Holding/ link to Top 10 holding of

	the underlying fund should be provided.
List of official points of acceptance:	Details to be uploaded and updated on a functional website link
Penalties, Pending Litigation or Proceedings, Findings of Inspections or Investigations For Which Action May Have Been Taken Or Is In The Process Of Being Taken By Any Regulatory Authority	AMCs to ensure real time updation of data on the said link.
Investor services	Details of related information/procedure/investor points <ul style="list-style-type: none"> • Contact details for general service requests • Contact details for complaint resolution
Portfolio Disclosure	<ul style="list-style-type: none"> • As per specified timelines i.e. Fortnightly / Monthly/ Half Yearly • Portfolio turnover rate (times) and policy
Detailed comparative table of the existing schemes of AMC	(As applicable)
Scheme performance	(As applicable)
Periodic Disclosures such as Half yearly disclosures, half yearly results, annual report	
Any disclosure in terms of Consolidated Checklist on Standard Observations	
Scheme specific disclosures	Refer the format given below

Format for Scheme Specific Disclosures:

Portfolio rebalancing	Timeline to be provided. For detailed disclosure, kindly refer SAI
Disclosure w.r.t investments by key personnel and AMC directors including regulatory	Amount of investment to be provided

provisions	For detailed disclosure, kindly refer SAI
Investments of AMC in the Scheme	Amount of investment to be provided For detailed disclosure, kindly refer SAI
Taxation	For details on taxation please refer to the clause on Taxation in the SAI
Associate Transactions	For detailed disclosure, kindly refer SAI
Listing and transfer of units	
Dematerialization of units	
Minimum Target amount (This is the minimum amount required to operate the scheme and if this is not collected during the NFO period, then all the investors would be refunded the amount invested without any return.)	
Maximum Amount to be raised (if any)	
Dividend Policy (IDCW)	
Allotment (Detailed procedure)	Mention, the procedure for allotment and dispatch of account statements/unit certificates. Indicate the time period. Mention the number of days within which the statement shall be dispatched to the unitholders who subscribe to the units when the scheme is open for continuous subscription after NFO as per the applicable guidelines.
Refund	If application is rejected, full amount will be refunded within 5 working days of closure of NFO. If refunded later than 5 working days @ 15% p.a. for delay period will be paid and charged to the AMC.
Who can invest This is an indicative list and investors shall consult their financial advisor to ascertain whether the scheme is suitable to their risk profile	
Who cannot invest	
The policy regarding reissue of repurchased units, including the maximum extent, the manner of reissue, the entity (the scheme	

or the AMC) involved in the same.	
Restrictions, if any, on the right to freely retain or dispose of units being offered.	
Cut off timing for subscriptions/ redemptions/ switches This is the time before which your application (complete in all respects) should reach the official points of acceptance.	
Minimum balance to be maintained and consequences of non-maintenance	
Accounts Statements	<p>The AMC shall send an allotment confirmation specifying the units allotted by way of email and/or SMS within 5 working days of receipt of valid application/transaction to the Unit holders registered e-mail address and/ or mobile number (whether units are held in demat mode or in account statement form).</p> <p>A Consolidated Account Statement (CAS) detailing all the transactions across all mutual funds (including transaction charges paid to the distributor) and holding at the end of the month shall be sent to the Unit holders in whose folio(s) transaction(s) have taken place during the month by mail or email on or before 15th of the succeeding month.</p> <p>Half-yearly CAS shall be issued at the end of every six months (i.e. September/ March) on or before 21st day of succeeding month, to all investors providing the prescribed details across all schemes of mutual funds and securities held in dematerialized form across demat accounts, if applicable</p> <p>For further details, refer SAI.</p>
Dividend/ IDCW	The payment of dividend/IDCW to the unitholders shall be made within seven working days from the record date.
Redemption	<p>The redemption or repurchase proceeds shall be dispatched to the unitholders within three working days from the date of redemption or repurchase.</p> <p>For list of exceptional circumstances refer para 14.1.3</p>

	<p>of SEBI Master Circular for Mutual Funds dated May 19, 2023</p> <p>For schemes investing atleast 80% of total assets in permissible overseas investments (as per Clause 12.19 of SEBI Master Circular for Mutual Funds dated May 19, 2023), the transfer of redemption or repurchase proceeds to the unitholders shall be made within five working days from the date of redemption or repurchase.</p>
Bank Mandate	
Delay in payment of redemption/repurchase proceeds/dividend	The Asset Management Company shall be liable to pay interest to the unitholders at rate as specified vide clause 14.2 of SEBI Master Circular for Mutual Funds dated May 19, 2023 by SEBI for the period of such delay
Unclaimed Redemption and Income Distribution cum Capital Withdrawal Amount	
Disclosure w.r.t investment by minors	
<i>Principles of incentive structure for market makers (for ETFs)</i>	
