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SEBI'S FRAMEWORK FACILITATING MUTUAL FUND DIRECT PLANS INVESTED THROUGH EXECUTION ONLY PLATFORMS

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Introduction

As on 30 April 2022, the assets under management of the mutual fund (MF) industry in India stands at INR 38.04 lakh crore, with 45% of the total assets being routed through direct plans. With increasing focus on financial literacy, digitization, online banking, smartphones, and awareness about MFs, investors can leverage technology and directly invest in MFs, thereby necessitating the need to regulate the domain, especially the digital / technology platforms through which the execution of MF investments is undertaken for a direct plan.

Background

Investment in MFs is made via two mechanisms: (a) a regular plan which requires routing the investment through an intermediary (a mutual fund distributor (MFD)); and (b) a direct plan in which the investment does not involve any distributor / agent. Understandably, investors prefer the direct plan having a lower expense ratio, without any commission being paid to the distributor / agent, which is added to their returns. Investors who prefer the direct plans, have the following channels available for investment through:

- the office / website / mobile app of the asset management company (AMC), in physical or digital mode;
- the SEBI registered stockbroker (SB) / investment adviser (IA) / portfolio manager (PM) in digital mode using the MF transaction platform provided by the stock exchanges;
- SEBI registered IA / PM directly with AMCs as their clients; or
- platforms like MF Utilities India Pvt. Ltd., MF Central, etc.

Several investors execute their MF investments through the technology / digital platforms provided by stock exchanges / registrar and transfer agents of MFs (RTAs) and IAs / SBs / PMs. Some investors who use the platforms provided by IAs / SBs / PMs do not avail their advisory and broking services, and only use the platforms for execution of their MF transactions. Investors usually prefer platforms provided by IA / SB / PM over those provided by stock exchanges / RTAs, due to their convenience. However, there is no specific framework exists governing the usage of platforms of IA / SB / PM for investors seeking execution only services.

Legal lacunae and rationale

Under the existing SEBI framework, the IAs / SBs / PMs, onboarding an investor as a client are required to enter into an agreement or secure the client's signature on mandatory terms, as prescribed by SEBI. The investors who use such platforms only for execution related services, i.e., non-clients, without availing any advisory / broking services of IAs / SBs may find it inconvenient to execute agreements having provisions mandated for IAs / SBs, as they may not be relevant for such non-clients. Generally, for investors, IAs / SBs / PMs typically use their registration codes to obtain the data outlining an overview of their investment transactions; however this benefit is not available to non-clients and they do not have any recourse or protection available under any regulatory framework. In light of the above, SEBI has on 22 July 2022, issued a consultation paper, proposing a new framework for execution only platforms (EOPs), to maintain a balance between convenience and investor protection. The stakeholders are required to provide their comments latest by 12 August 2022.

Overview

EOPs may consider various structural approaches, of either – (a) registering with SEBI as an intermediary; or (b) registering with the association of mutual funds of India (AMFI); or (c) obtaining a limited purpose membership with the stock exchanges.

Salient Features –

- Scope of service – EOPs may provide both financial services viz., purchase and redemption of MF units, etc., and non-financial services viz., change of email id, contact number, bank account details, complaints, etc. Only a body corporate may be registered as an EOP, and it should not carry out other activities. In case the EOP is undertaking other activities as well, an arm's length relationship is to be maintained between their EOP activity and other activities. The EOP services must be provided through a separately identifiable EOP department. Since EOPs are digital platforms, cybersecurity concerns also need to be addressed.
- EOP conditions for registration / limited purpose membership –
 - pre-requisite adequate infrastructure
 - minimum net worth: (i) either ensuring commensurate capital with the required scale of operations, infrastructure, and future growth projections; or (ii) as prescribed by AMFI and Stock Exchanges.
 - Infrastructure and manpower: (i) either for management of risk and having checks and balances for cybersecurity, data processing, and data privacy including appropriate technological, operational, legal, and financial systems and resources; or (ii) as per minimum requirements prescribed by AMFI and Stock Exchanges.
 - Fit and proper criteria – (i) either as prescribed in Schedule II of SEBI (Intermediaries) Regulations, 2008; or (ii) as per minimum requirements prescribed by AMFI and Stock Exchanges.
- General obligations and responsibilities –
 - Visibility of client transactions: EOPs to have visibility of the client's transaction data feeds from RTAs for the transactions executed through their platform. The SEBI / AMFI registration number or limited purpose membership number provided by stock exchanges may be used as the code to get such data from RTAs / stock exchanges.
 - Use and sharing of client data: in line with the agreement governing the client relationship with the EOPs.

- Agreements: EOPs may enter into a contractual agreement with (a) AMCs or RTAs / depositories (if authorized by an AMC); or (b) stock exchanges, to integrate their systems and to provide execution services for direct MFs.
 - Client Level Segregation: EOPs to ensure client level segregation with reference to their activities as EOP, IA / SB / PM and MFD activities.
 - Fees: EOPs may only receive transaction-based fees either (a) from the clients; or (b) from AMCs, in the manner as specified by AMFI.
- Transparency and Grievance Redressal -
- Client onboarding: (a) EOPs will either enter into a mandatory agreement with the client at the time of onboarding and ensure KYC compliance; or (b) Investors can be directly boarded in compliance with the KYC process which shall be ensured by the AMCs.
 - Grievance redressal mechanism - it may either be: (a) as prescribed for other SEBI registered intermediaries (through SCORES); or (b) as prescribed for MFDs wherein AMC shall monitor the EOP activities to ensure compliance with the code of conduct and other guidelines. The AMC shall report to AMFI and SEBI, any instance of material breach in adherence to applicable guidelines; or (c) as prescribed by the stock exchanges in consultation with SEBI.

Comments

The various approaches recommended by SEBI, would need to be considered bearing in mind the intent to reduce any intermediary involvement, eliminate any layering or superstructure in the implementation of EOPs, and fully implement the direct plan of MFs. In the interest of the investors, a robust cyber security and cyber resilience framework for the EOPs is recommended, and their use of client data must be in compliance with the agreement executed with the client and the data protection framework. The framework aims at an investor centric mechanism to ensure the EOPs only function as agents of the investors, and their fee structure is based on investor pay model.

The proposed framework will affect the investech platforms like Paytm Money, Zerodha, and Groww, which offer direct MFs requiring them to register as intermediaries. This move seeks to promote the ease of doing business in MFs, coupled with adequate investor protection and grievance redressal mechanism, by providing an impetus to the investors' direct investment in MFs, through use of digital technology platforms.

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