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Association of Mutual Funds in India

BUDGET PROPOSALS FOR FY 2021-22

Contents

A. Need to bring parity in tax treatment for investments in different financial sectors

1. Need to bring parity in tax treatment for investments in Mutual Funds Units and ULIPs of Life Insurance companies		
Background	**Proposal**	**Justification**
1 (a) Request for uniform tax treatment on Switching of Investments under Mutual Fund schemes and ULIPs of Insurance companies		
• As per SEBI Mutual Funds Regulations, mutual funds offer 'Direct Plan' wherein investors can invest directly, i.e., without involving any distributor/agent and a "Regular Plan", wherein one may invest through a distributor/agent (who gets commission). Direct Plan has lower expense ratio than Regular Plan, as there is no intermediary involved, and hence there is saving in terms of distribution cost/commission. Direct Plan and Regular Plan are part of the same mutual fund scheme, and have the same / common portfolio, but have different expense ratios (recurring expenses that is incurred by the MF). • Mutual Funds also provide "GROWTH" option and "DIVIDEND" option. Under Growth Option, the income generated / earned remains invested in the scheme and is reflected in the appreciation in the NAV of growth option. Under Dividend Option, the income generated / earned is paid/distributed to the unitholders. • Under the current Tax regime, "switching" of investment in Units within the same scheme of a Mutual Fund from Growth Option to Dividend Option *(or vice-versa)*, and from Regular Plan to Direct Plan *(or vice-versa)* is considered a "Transfer" and is liable to capital gains tax, even though the amount invested remains in the mutual fund scheme, *i.e., <u>even though there are no realized gains</u>*, as the underlying securities/ portfolio remains unchanged within the scheme. • However, the switching of investments to/from investment plans to another within the same Unit Linked Insurance Plan (ULIP) of insurance companies is not considered as a "Transfer" and hence, **<u>not</u>** subjected to any Capital Gains Tax. Thus, there is a lack of uniformity in tax treatment on switching of investment within a Mutual Fund schemes and within a ULIPs of Insurance companies, ***although both MF units and ULIPs invest in securities, and are investment products***.	• It is proposed that in case of Intra-Scheme Switches, i.e., switching of investment within the same scheme of a Mutual Fund is not regarded as a "Transfer" under Section 47 of the IT Act, 1961 and should be exempt from payment of capital gains tax. • It is therefore requested that a new sub-section under Section 47 of the Income Tax Act, 1961 be inserted {on the lines of sub-sections 47(xviii) and 47(xix)}, so that Switching of Units from (a) Regular Plan to Direct Plan or vice-versa; and (b) Growth Option to Dividend Option or vice-versa, within the SAME scheme of a mutual fund are not regarded as transfer and hence, shall not be charged to capital gains.	1. In respect of switching of Units within the same scheme of a Mutual Fund from Growth Option to Dividend Option or vice-versa, there is no realised gain, since the investment remains within the SAME mutual fund scheme, as the underlying securities/ portfolio remains unchanged. 2. As per extant provisions of Income Tax Act, 1961, the following transactions are not be regarded as transfer and hence, shall not be charged to capital gains: *(i) Transfer of units of a mutual fund pursuant to consolidation of two or more schemes of equity oriented mutual fund or of two or more schemes of a mutual fund other than equity oriented mutual fund {section 47 (xviii)}.* *(ii) Transfer of units of a mutual fund from one plan to another pursuant to consolidation of plans within scheme of mutual funds {section 47 (xix)}* 3. Extending the above principle and rationale, it follows that a switch transaction from one Plan/Option to another Plan/Option within the same scheme of a Mutual Fund should also not be regarded as transfer and hence, not subjected to Capital Gains Tax. 4. It may be added here that switch transactions to/from various investment plans within the same ULIP of life insurance companies are not regarded as transfer and hence, not subjected to Capital Gains Tax. In its "*Long Term Policy for Mutual Funds*", SEBI has emphasized the principle that **similar products should get similar tax treatment**, and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators. 5. Thus, there is need to have uniformity in the tax treatment for "Switch" transaction in respect ULIPs and Mutual Fund Products to have a level playing field.

1 (b) Request for Uniform tax treatment on Capital Gains from Mutual Funds investments and ULIPs of Insurance companies		
Background	**Proposal**	**Justification**
Long-Term Capital Gains (LTCG) arising out of the sale of listed equity shares and Units of equity-oriented mutual fund schemes are now taxed at the rate of 10%, if the LTCG exceed ₹1 lakh in a financial year (gains up to January 31, 2018 being *grandfathered*). However, the proceeds from ULIPs of Insurance companies (including early surrender / partial withdrawals), are exempted from income tax *under section 10(10d) of Income Tax Act*, if the sum assured in a life insurance policy is at least 10 times the annual premium and withdrawn after a lock-in of 5 years, even though ULIPs are also investment products that invest in equity stocks, just like mutual funds, and with added advantage of tax deduction under Section 80C of the Income Tax Act on the premium paid. Thus, there is a clear case of tax arbitrage, whereby ULIPs are not only placed at an advantageous position vis-à-vis Mutual Fund Schemes, but there is also a significant revenue leakage on capital gains from ULIPs, especially from HNI segment, which needs to be plugged, considering the potential loss to the exchequer if this loophole / arbitrage is continued.	• It is proposed to bring parity in tax treatment in respect of capital gains on withdrawal of investments in ULIPs of Life Insurance companies and redemption of Mutual Funds Units, so as to bring about level playing field between ULIPs and MF schemes.	Although ULIPs are considered as insurance products for tax purposes, ULIPs are also investment products that invest in securities like mutual funds, but with insurance benefit. With high commissions and incentive structure prevailing in the life insurance sector – a point that the Sumit Bose Committee report (2015) had highlighted – and a lucrative tax arbitrage, there is a potential revenue leakage of LTCG tax of 10.4% on the gains from ULIPs, especially from HNI segment, which could be significant. We have been highlighting about the tax arbitrage in the past also, so that there is a level playing field among the players in financial industry.

1 (c) Request for removal of Tax Arbitrage between ULIPs & Equity MF Schemes on account of STT		
Background	**Proposal**	**Justification**
In 2004, the government had introduced the Securities Transaction Tax (STT), when LTCG Tax on sale of equity shares and equity-oriented mutual fund schemes was abolished. However, although LTCG on sale of listed equity shares and Units of equity-oriented mutual fund schemes has been re-introduced in Finance Act, 2018, STT has not been abolished. In respect of Equity Oriented Funds (EOF), the Mutual Funds are required to pay STT on every purchase or sale of securities. In addition, the unitholders are required to pay the STT on the redemption value at the time of redemption of units. Thus, there is a double levy of STT for an investor investing in the equities through equity mutual fund scheme. And in respect of Exchange Traded Fund (ETF), the investor of the ETF has to pay STT on the purchase as well as sale of units in the ETF. **However, there is no STT levied on the withdrawal proceeds from ULIPs. Thus, on this count also there is a clear case of tax arbitrage, whereby mutual funds are at a disadvantage vis-à-vis the ULIPs.**	• It is proposed to abolish the STT levied at the time of redemption of Mutual Fund Units by the investor.	a) ULIPs are essentially investment products like mutual funds, with an added insurance benefit and tax benefit under Section 80C. b) In SEBI's "Long Term Policy for Mutual Funds" published in Feb.2014, it has been emphasized that there was a need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators similar products should get similar tax treatment. c) Hence, there is a need to ensure level playing field between mutual fund investments and ULIPs.

2. Request for Uniformity in Taxation on Listed Debt Securities and Debt Mutual Funds

Background	Proposal	Justification
In his 2014 Budget Speech, the then Hon'ble Finance Minister, late Shri Arun Jaitley, had mentioned that investment in debt securities, either directly or through Mutual Funds should be at par for retail investors, at the same time acknowledging that retail participation in debt Mutual Funds was limited. However, the amendments made in the Finance Act, 2014, somehow did not completely address the disparity and the difference between tax treatment of direct and indirect investment into debt securities has continued. Currently, the minimum holding period for Units of debt-oriented mutual funds (listed or unlisted) to qualify as Long-Term Capital Asset is more than 36 months. However, direct investments in a listed securities such as bonds/debentures, Government Securities, derivatives, etc. listed on a recognised stock exchange in India and Zero Coupon Bonds (listed or unlisted) the holding period to qualify as Long Term Capital Asset is just 12 months. It is ironical that the holding period indirect investments made in the above securities through a Debt-oriented Mutual Fund scheme is increased to 36 months, for being regarded as long-term investment, while it is just 12 months for direct investments in listed debt securities. There is a also revenue leakage on account of the tax arbitrage especially in respect of investment in Zero Coupon Bonds, as many HNIs are understood to have shifted their debt investments to listed zero coupon bonds, and thus managed to reduce their tax liability from peak rate of 43% to 10 % under LTCG. Thus, there is a need for harmonizing the tax treatment on investments in debt oriented MFs and direct investments in debt securities.	The holding period for long term capital gains for direct investment in listed debt securities / and Zero-Coupon Bonds (listed or unlisted) and for investment through debt mutual funds should be harmonized and made uniform. This may be done by bringing the two at par in either by – (i) treating investments in non-equity oriented mutual fund schemes **which invest 65% or more in listed debt securities as long term**, if they are held for more than 12 months OR (ii) increasing the minimum holding period for direct investment in listed debt securities / and Zero-Coupon Bonds (listed or unlisted) to 36 months to qualify as Long-Term Capital Asset.	It is only logical and fair to bring parity in tax treatment for direct investment in listed debt securities and indirect investment in the same instruments through debt-oriented mutual fund schemes. This parity between direct investments in a listed security (by corporates & HNIs) and indirect investments made through mutual funds by retail investors would also prevent tax revenue leakage.

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B. Suggestions to mitigate hardship to retail tax payers

3. Increase in threshold limit of withholding tax (TDS) on Income distribution by Mutual Fund scheme		
Background	**Proposal**	**Justification**
Presently withholding tax is applicable on income distribution by Mutual fund scheme to the resident unit holders as per provision of section 194 K of The Income Tax Act, 1961. Further, there is threshold limit, where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year by the person responsible for making the payment to the account of, or to, the payee **does not exceed five thousand rupees**;	It is requested that the threshold limit for withholding tax (TDS) on income distribution (dividend) on mutual fund units be increased from ₹5,000 to ₹50,000 p.a.	The threshold limit of ₹5,000 for TDS on income (dividend) distribution on mutual fund units is too meagre and very low as compared to the threshold limit of ₹40,000 applicable on interest on bank FD. It is pertinent to mention here that the threshold limit for TDS on interest on time deposit was raised from ₹10,000 to ₹40,000 in the last year's budget. It may be recalled that years ago, when TDS was applicable on dividend from mutual fund Units and equity shares of companies, the threshold limit for TDS was ₹10,000. Increasing the threshold limit to ₹50,000 would mitigate the hardship faced small retail investors, who would otherwise will have to claim the refund of TDS in the next AY.

4. The rate of Surcharge applicable to dividend paid on equity mutual funds units to non-corporate asssessees (such as Individual, HUF, AOP, Body of Individuals and Artificial Juridical Person) to be harmonized		
Background	**Proposal**	**Justification**
The definition of "dividend" provided under section 2(22) of the Act is an inclusive definition, wherein the reference is made to distribution in various forms by a company and does not cover distribution of income in respect of units of mutual funds. Finance Act, 2020 has capped the surcharge rate on 'dividend income' on equity shares @ 15% in the hands of non-corporate taxpayers. However, there is no similar capping on the rates of surcharge in respect of income distribution from equity schemes of mutual fund. Consequently, MF investors are required to pay higher surcharge at rates ranging from 25% or 37%.	It is proposed that, similar to the cap of 15% on surcharge rate on dividend income earned by non-corporate assessee (including residents and Foreign Portfolio Investors) on equity shares, the surcharge rate on income distribution on Units from equity mutual funds schemes should also be capped at 15%.	It is logical and fair to bring parity in surcharge on TDS from dividend from equity shares and Units of equity oriented mutual fund schemes.

C. Suggestions to encourage deepening of capital market through Mutual Funds

5. Introduce Debt Linked Savings Scheme (DLSS) to help deepen the Indian Bond Market.		
Background	**Proposal**	**Justification**
• Over the past decade, India has emerged as one of the key financial market in Asia. However, the Indian corporate bond market has remained comparatively small and shallow, which continues to impede companies needing access to low-cost finance. • Historically, the responsibility of providing debt capital in India has largely rested with the banking sector. This has resulted in adverse outcomes, such as accumulation of non-performing assets of the banks, lack of discipline among large borrowers and inability of the banking sector to provide credit to small enterprises. Indian banks are currently in no position to expand their lending portfolios till they sort out the existing bad loans problem, especially post Covid19 pandemic. • Hence, there is a need for a vibrant bond market in India, to provide an alternative platform for raising debt finance and reduce dependence on the banking system. • The heavy demands on bank funds by large companies, in effect, crowd out small enterprises from funding. India needs to eventually move to a financial system where large companies get most of their funds from the bond markets, while banks focus on smaller enterprises. • While it is highly unlikely that the corporate bond market will ever replace banks as the primary source of funding, experts agree that India needs a livelier corporate bond market.	• It is proposed to introduce **"Debt Linked Savings Scheme" (DLSS)** on the lines of Equity Linked Savings Scheme (**ELSS**) to channelize long-term savings of retail investors into higher credit rated debt instruments with appropriate tax benefits which will help in deepening the Indian Bond Market. • At least 80% of the funds collected under DLSS shall be invested in debentures and bonds of companies as permitted under SEBI Mutual Fund Regulations. Pending investment of the funds in the required manner, the funds may be allowed to be deployed in money market instruments and other liquid instruments as permitted under SEBI MF Regulations. • It is further proposed that the investments upto ₹1,50,000 under DLSS be eligible for tax benefit under a separate sub-Section and subject to a lock in period of 5 years (just like tax saving bank Fixed Deposits). • CBDT may issue appropriate guidelines / notification in this regard as done in respect of ELSS.	• The introduction of DLSS will provide an alternative fixed income option to retail investors. • It will also help take away burden from the Government on higher cost of borrowing on small savings instruments. • The Government's plans to significantly increase investment in the infrastructure space will require massive funding and the banks may not be equipped to fund such investments. • This can also play a part in disciplining companies that borrow heavily from banks to fund risky projects, because the borrowing costs would spike. If large borrowers are persuaded to raise funds from the bond market, it will increase bond issuance over time and attract more investors, which will also generate liquidity in the secondary market. • A vibrant corporate bond market is also important from an external vulnerability point of view, as a dependence on local currency and markets will lower risks. • Therefore, to deepen the Indian Bond market and strengthen the efforts taken by RBI and SEBI for increasing penetration in the corporate bond markets, it is expedient to channelize long-term savings of retail segment into corporate bond market through Mutual funds on the same lines as ELSS. • DLSS will help small investors participate in bond markets at low costs and at a lower risk as compared to equity markets. This will also bring debt oriented mutual funds on par with tax saving bank fixed deposits, where deduction is available under Section 80C.

6. Mutual Funds should be allowed to launch, 'Mutual Fund Linked Retirement Plan' with Uniform Tax Treatment as NPS		
Background	**Proposal**	**Justification**
Presently, there are three broad investment avenues for post-retirement pension income in India, namely: (i) National Pension System (NPS). (ii) Retirement /Pension schemes offered by Mutual Funds. (iii) Insurance-linked Pension Plans offered by Insurance companies. With an objective to encourage retirement planning, government has through PFRDA, introduced NPS, wherein the contributions made to NPS are eligible for tax exemptions under a dedicated section, namely, 80 CCD(1) & 80 CCD (1B) of Income Tax Act, 1961. Currently Mutual Fund Retirement Benefit / Pension Schemes qualify for tax benefit under Sec.80C. But each Mutual Fund Pension Scheme needs to be Notified by CBDT for being eligible for tax benefit u/Section 80C on a case-by-case basis involving a long bureaucratic process. It may be recalled that in the 'Key Features of Budget 2014-2015' there was an announcement under 'Financial Sector - Capital Market' about "UNIFORM TAX TREATMENT FOR PENSION FUND AND MUTUAL FUND LINKED RETIREMENT PLAN" (on Page 12 of the Budget Highlights document). This implied that Indian Mutual Funds would be able to launch Mutual Fund Linked Retirement Plans (MFLRP) which would be eligible for the same tax concessions available to NPS. However, there was no reference to this either in the budget speech of the Finance Minister, nor in the Budget, disappointing the Mutual Fund industry.	i. It is proposed that all SEBI Registered Mutual Funds should be allowed to launch pension plans, namely, 'Mutual Fund Linked Retirement Plan' (**MFLRP**), which would be eligible for tax benefits under Sec. 80CCD (1) & 80CCD (1B) of Income Tax Act, 1961, with Exempt-Exempt-Exempt (E-E-E) status on the principle of similar tax treatment for similar products. ii. Where matching contributions are made by an employer, the total of Employer's and Employee's contributions should be taken into account for calculating tax benefits. iii. Contributions made by employer should be allowed as an eligible 'Business Expense' under Section 36(1) (iv a) of Income Tax Act,1961. iv. Likewise, contributions made by the employer to MFLRP Schemes up to 10% of salary should be deductible in the hands of employee, as in respect of Section 80 CCD (2) of the Income Tax Act, 1961. v. Withdrawals made from MFLRP should be exempt from income tax upto the limits specified for tax- exempt withdrawals from NPS as in section 10(12A) and 10(12B) of the Income Tax Act, 1961. vi. The switches of MFLRP investments between mutual funds should not be treated as transfer and should be exempted from capital gain tax. vii. It is also requested that CBDT, in consultation with SEBI, may issue appropriate guidelines / notification in this regard as done in respect of ELSS, obviating the need for each Mutual Fund to apply individually to CBDT to notify its MFLRP as being eligible for tax benefit u/Sec.80CCD.	• SEBI, in its "Long Term Policy for Mutual Funds" released in Feb. 2014, had proposed that Mutual Funds be allowed to launch pension plans, namely, Mutual Fund Linked Retirement Plan' (**MFLRP**) which would be eligible for tax benefits akin to *401(k) Plan* in the U.S. • It was also emphasized in the aforesaid Long Term Policy that similar products should get similar tax treatment, and the need to eliminate tax arbitrage that results in launching similar products under supervision of different regulators and the need for restructuring of tax incentive for Mutual Fund Pension schemes. • Thus, there is very strong case for bringing Mutual Funds Retirement Benefit / Pension Schemes under Sec. 80CCD instead of Sec.80C to bring parity of tax treatment for the pension schemes and ensure level playing field. • Allowing Mutual Funds to launch MFLRP would bring pension benefits to millions of Indians in unorganized sector. • Empirically, tax incentives are pivotal in channelising long-term savings. For example, the mutual fund industry in the United States witnessed exponential growth when tax incentives were announced for retirement savings. Market-linked retirement planning has been one of the turning points for high-quality retirement savings across the world. Investors have a choice in the scheme selection and flexibility. • A long-term product like MFLRP can play a catalytical role in channelizing household savings into securities market and bring greater depth. Such depth brought by the domestic institutions would help in balancing the volatility in the markets and would reduce reliance on the FPIs. • Going forward, pension funds will emerge as sources of funds in infrastructure and other projects with long gestation period, as well as for providing depth to the equity market (perhaps looking for absorbing stocks arising out of disinvestment program of the government).

7. Mutual Fund Units should be notified as 'Specified Long-Term Assets' qualifying for exemption on LTCG under Sec. 54 EC		
Background	**Proposal**	**Justification**
In 1996, Sections 54EA and 54EB were introduced under the Income Tax Act, 1961 with a view to channelize investment into priority sectors of the economy and to give impetus to the capital markets. Under the provisions of Sec. 54EA and 54EB, capital gains arising from the transfer of a long-term capital asset on or after 01-10-1996, were exempted from capital gains tax if the amount of net consideration (Section 54EA) or the amount of capital gain (Section 54EB) was invested in certain specified assets, including mutual fund units, redeemable after a period of three / seven years. (cf: Notification No. 10248 [F. No. 142/58/96-TPL], dated 19-12-1996). However, Sec. 54EA and 54EB were withdrawn in the Union Budget 2000-01 and a new Section 54EC was introduced, whereby tax exemption on long-term capital gains is allowed only if the gains are invested in specified long-term assets (currently in bonds issued by the NHAI & REC) that are redeemable after three years. Under Sec. 54, long term capital gains arising to an individual or HUF from the sale of a residential property are exempt from capital gains tax, if the gains are invested in a new residential property either bought within two years or constructed within three years from date of transfer of existing property. In case of buying a new property, the exemption is available even if it is bought within one year before the date of transfer.	It is proposed that, mutual fund units wherein the underlying investments are made into specified *infrastructure sub-sector* as may be notified by the Government of India, be also included in the list of the specified long-term assets under Sec. 54EC. While the underlying investment could be made in securities in infrastructure sub-sector as specified above, the mutual fund itself could be equity-oriented scheme or debt-oriented scheme. Further, the aforesaid investment can have a lock in period of three years to be eligible for exemption under Sec. 54EC.	The Government's plans to significantly increase investment in the infrastructure space will require massive funding and the banks may not be equipped to fund such investments and bonds issued by REC or NHAI may be inadequate. Investment in the specified mutual fund schemes can provide an alternative investment avenue in addition to existing options to the investors and also provide an option to earn market related returns. It will also help ease the burden cost of borrowing for infrastructure funding on the Government. Recognizing the need to channelize long term household savings into Capital Market, the Government has been taking various measures to encourage individual taxpayers to invest in capital markets via mutual funds. After withdrawal of Section 54EA and 54EB in 2000, the inflow of Long-Term Capital Gains from sale of property, which would have otherwise flowed into capital market, has altogether stopped. Tax benefit under Sec. 54 EC for investment in the specified mutual fund scheme will help channelize the gains from sale of immovable property into capital markets through mutual fund route and thus augment governments efforts to improve the country's economy.

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8. Need to further simplify Taxation provisions of offshore funds managed by Indian portfolio managers		
Background / Issue	**Proposal**	**Justification**
India continues to be an important investment destination despite the recent economic slowdown. Many of the India focused overseas funds typically have a structure where the investment manager is based outside India and is supported by an investment adviser based in India. To encourage the fund management activities of offshore funds from India, a "Safe Harbour" regime for onshore management of offshore funds, section 9A was introduced in the Income-tax Act in the year 2015, which provided that the presence of a fund manager/an investment adviser in India would not constitute business connection, permanent establishment or a tax residence for the offshore funds in India, *subject to fulfilment of the prescribed conditions*. However, some of the conditions were quite onerous in nature, e.g., one of the conditions to qualify for the Safe Harbour was for the eligible fund manager to receive an arm's length remuneration, and for the transaction between the eligible investment fund and eligible fund manager to be deemed an international transaction, subject to transfer pricing provisions. Although Finance Act, 2019 has removed the above requirement, replacing it with a minimum fee to be prescribed by CBDT and CBDT has since notified the amendment to Rule 10V, the Indian fund management industry has not been able to take advantage of the safe harbour provisions in section 9A due to the requirements still being too onerous or generally impractical for investment funds. Consequently, only a handful of offshore funds have availed of the safe harbour benefit.	It is requested that the onerous conditions under Section 9A of the Act, be further to simplified to encourage fund management activity from India and provide safe harbour in respect of offshore funds, as detailed in para 8(a) to 8(e) below. It is also suggested that some or all the conditions relating to safe harbour need to be deleted for Portfolio Managers/ Advisors operating from the International Financial Services Centre (IFSC), GIFT city, Gujarat.	Creating a tax environment which encourages Indian portfolio managers to manage global mandates from India rather than from abroad will bring economies of scale, more jobs and help develop India as a regional financial centre.
8 (a) Participation of residents in the Fund – Sec. 9A(3)(c)		
The condition with regard to aggregate participation or investment in the fund, directly or indirectly, by persons resident in India to not exceed five percent of the corpus of the fund, is difficult to monitor especially in case of indirect participation.	Section 9A(3)(c) should be amended as under: ***"The aggregate participation or investment in the fund, directly or indirectly, by persons resident in India shall not exceed the threshold prescribed by the Securities and Exchange Board of India in this regard"*** Alternatively, section 9A(3)(c) should be amended as under: ***"The aggregate direct participation or investment in the fund, by person resident in India does not exceed five percent of the corpus of the fund"***	• Practical challenges for retail funds to monitor indirect participation of persons resident in India, especially on continuous basis. • Given that KYC requirements under the SEBI FPI Regulations 2019 have a threshold for identification of beneficial owners, there is a relative disadvantage on marketability of FPIs availing safe harbour regime vis-à-vis FPIs not availing safe harbour regime.

8 (b) Minimum corpus of the fund – Sec. 9A(3)(j)		
There is a requirement that the monthly average of the corpus of the fund shall not be less than one hundred crore rupees, which makes it difficult for some of the new funds to satisfy especially in Covid times.	It is requested to delete section 9A(3)(j)	New funds require time to build track record for performance in which scenario the minimum corpus of hundred crore rupees may not be achieved.
8 (c) Investment diversification condition – Sec. 9A(3)(e), 9A(3)(f) and 9A(3)(g)		
Earlier, Category I and Category II FPIs registered under the erstwhile regulations were exempt from diversification conditions. SEBI (FPI) Regulations, 2019 has re-categorised funds based on the country of domicile and the regulated status in that country. Category II FPI not only includes family offices, individuals, corporate bodes, but also include appropriately regulated funds not eligible as Category I FPI. Exemption from diversification conditions has been restricted only to Category I FPIs. However, funds that fall under Category II FPI that are appropriately regulated but not eligible for registration as a Category I FPI are required to satisfy diversification conditions and which are very onerous.	Diversification conditions specified under clause (e), (f) and (g) of section 9A should not be applicable to a Category II FPIs (except individuals, corporate bodies and family offices)	• The change will seriously impact regulated broad-based funds domiciled in non-FATF member countries • Operational Guidelines under SEBI (FPI) Regulations, 2019, treat appropriately regulated funds under Category II FPI at par with Category I FPIs for the purpose of KYC declarations, exemptions and limits such as margining of trades, position limits in certain derivative contracts. • Similarly, under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, “Qualified institutional buyer” status has been granted to Category I FPIs as well as to appropriately regulated funds registered as Category II FPI.
8 (d) Connected person condition – Sec. 9A(4)(a)		
In case the eligible fund and the eligible fund manager are regarded as ‘connected persons’, then it would not be possible for any fund to satisfy the aforesaid condition.	Delete section 9A(4)(a) or introduce an objective definition of ‘connected persons’ relevant in the context of fund management industry	The definition of ‘connected persons’ is taken from section 102(4) of the Income tax Act, 1961. The definition of ‘connected persons’ provided in section 102(4) of the Act is subjective and very wide.

8 (e) Profits entitled to fund manager - 9A(4)(d)		
There could be challenges to apply the condition in certain situations such as (a) post redemption, the overall gain has turned into losses for the fund at the financial year end, (b) period for calculating performance profits not aligned with the financial year (as calculated on a calendar year) and (c) Multi share class vehicle.	Delete section 9A(4)(d)	As long as there are inflows into India which would mean more revenue coming into the country, there should not be any requirement to cap the fees at 20% of profits.

9. Request to permit Insurance Companies to outsource the Fund Management activities to SEBI Registered MF AMCs		
Background	**Proposal**	**Justification**
The global practice adopted by the Insurance industry abroad is that of open architecture of fund management. In this regime, insurance companies create appropriate products and utilize the services of professional asset managers in discharging its investment management function. This process is widely followed to optimize the investment expertise domiciled with asset management industry. Insurance companies provide full disclosure of the AMC engaged by them in providing asset management / advisory services.	It is recommended that all IRDA-registered Insurance companies be permitted to outsource the Fund Management activities to SEBI Registered Mutual Fund Asset Management Companies (AMCs) and the AMCs be permitted to provide Fund Management / Asset Management services to the Insurance companies by appropriate amendments to relevant SEBI & IRDA Regulations.	This would result in both MF & Insurance industries complementing each other in accessing households with financial products which could be simple investment products manufactured by the Asset Management industries or Insurance products which could bundle an element of investment. Hence the AMCs with Mutual Fund products never really compete or conflict with Insurance products. There is an urgent need for the Indian regulatory regime to recognize that investors could choose an Insurance product of an insurance company with the full knowledge that the investment management function thereof is managed by an AMC which has been chosen by the insurance provider. This would, in fact, provide the insurance policy buyer multiple options on choosing insurance products with different asset managers. It would also bring about optimization of cost across both industries.

10. CPSE investment of surplus funds in Mutual Funds

Background / Issue	Proposal	Justification
As per the extant DPE guidelines regarding investment of surplus funds by the CPSEs vide Office Memorandum F. No. DPE/18/(1)/2012-Fin dated May 8, 2017, *Maharatna, Navratna and Miniratna CPSEs* are permitted to invest their surplus funds in mutual funds subject to the following conditions – a) *They may invest only in debt-based schemes of* ***public sector mutual funds****.* b) *Investment in mutual funds shall not exceed 30% of the available surplus funds of the concerned CPSE.* c) *The mutual fund debt scheme should have –* - *corpus amounting to at least ₹1000 Crore for the scheme at the time of investment, as per the latest published information; and* - *been accorded highest mutual fund rating by any two of the Credit Rating Agencies registered with SEBI.* d) *The period of maturity, including cases of residual maturity, of any instrument of investment shall not exceed one year from the date of investment. However, in the case of term deposits with banks and GOI securities, it may be up to three years from the date of investment.* e) *If any statutory guidelines have been issued by the sectoral regulatory authority such as RBI, SEBI etc., on investment of surplus funds, the DPE guidelines will be applicable to CPSEs only to the extent that the same are not contrary to the guidelines laid down by such regulatory authority.* *Since investment in debt schemes of mutual funds are subject to market risks, the track-record of the scheme shall be taken into account for taking investment decisions.* Although the revised guidelines have covered the 'Maharatna CPSEs', there is continued restriction on the CPSEs to invest their surplus funds of only in public sector mutual funds, as result of which the lack of level playing field between the public sector and private sector mutual funds continues to prevail in this regard.	It is requested to – 1. Revise the current DPE guidelines, and permit the Maharatna, Navratna and Miniratna CPSEs to invest their surplus fund in ***any*** SEBI registered Mutual Fund, irrespective of whether it is a public sector mutual fund or a private sector mutual fund; 2. Enhance the current limit of 30% of available surplus funds for investments in mutual funds by CPSEs to 50% of available surplus funds; 3. Not to stipulate any minimum corpus size in respect of the debt scheme as a pre-condition for investments by CPSEs; 4. Instead of the debt scheme requiring rating by any two separate Credit Rating Agencies, rating of only one SEBI-registered Credit Rating Agency may be accepted as adequate. 5. The period of maturity, including residual maturity in respect of debt mutual fund schemes may also be permitted / extended upto three years from the date of investment, in line with the extant provisions for deployment of surplus funds in term deposits with banks and GOI securities.	The current investment restrictions on CPSEs is rather monopolistic and restrictive, as it denies good investment opportunity to the CPSEs who are compelled to invest their surplus funds only in public sector Mutual Funds, thereby losing competitive opportunity to invest in private sector Mutual Funds with good track record. In turn, this prevents healthy competition and level playing field amongst various MF players. ***The DPE Guidelines also imply that PSU Mutual Funds are safer and / or more capable to manage the funds of CPSEs, although, all Mutual Funds operate under the same regulatory framework and operate in the same competitive environment.*** Over the years, private sector mutual funds have steadily overtaken the PSU mutual funds, both in terms of Assets Under Management (AUM) and number of investor accounts, which is evident in the factual data presented below: → Currently, out of 44 Mutual Funds (including 2 Infrastructure Debt Funds) registered with SEBI, only 6 are "PSU Mutual Funds". → As on October 31, 2020, the aggregate AUM of the Indian Mutual Fund Industry was ₹ 28,22,941 crore, out of which, the AUM of PSU Mutual Funds was ₹ 4,66,027 crore (i.e., about 16.50% of the aggregate Industry AUM), while the AUM of other non-PSU Mutual Funds was ₹ 23,56,914 lakh crore (i.e. 83.50% of the Industry AUM). → In terms of investor folios (accounts), as on October 31, 2020 the PSU Mutual Funds had an aggregate of around 1.29 crore folios (13.75%), while private sector funds had 8.08 crore folios (86.25%). ***The above data clearly indicates the level of trust, credibility and track record which the private sector mutual funds have built over the last two decades.*** Considering the performance of mutual funds vis-à-vis other alternate investment avenues and the fact that mutual funds provide better liquidity, especially in respect of open ended schemes, there is also a strong case for enhancing the existing prescribed limit of surplus funds which CPSEs could invest in mutual funds having equity investments, as it will help the CPSE to get better returns and liquidity.

Further, the condition that the mutual fund debt scheme should have a corpus of at least ₹1000 Crore at the time of investment is restrictive and against the interest of smaller or newer mutual funds. It is also felt that requirement that the mutual fund scheme should have highest rating by any two of the Credit Rating Agencies (CRA) is not warranted, and it should be sufficient if a debt scheme has the requisite rating from one CRA. The restriction on the period of maturity of the investment, including residual maturity not exceed one year is also rather restrictive, as the CPSEs will not be able to invest in longer duration schemes especially fixed maturity plans with three-year maturity, which are designed to provide tax efficiency to the investors on account of indexation benefits.		It is also pertinent to mention here that PSU Banks and Financial Institutions themselves do not differentiate between private sector and public sector Mutual Funds and make their investment decisions based on track record and returns rather than on ownership structure. Further, the PSEs do not differentiate between private-sector banks and public-sector banks, when they invest in bank deposits, nor is there any restriction imposed on them to carry on banking activities only with PSU Banks. In SEBI's "**Long Term Policy for Mutual Funds in India**" released in February 2014, it has been recommended at para 3.8.6 that ALL CPSEs should be allowed in invest surplus funds in mutual funds and be allowed to choose from any / all SEBI registered mutual funds (irrespective of whether a mutual fund is sponsored by a Public-Sector enterprise or otherwise). **Thus, there is a very strong case for allowing CPSEs to invest their surplus fund in <u>any</u> SEBI registered Mutual Funds, irrespective of whether it is a public sector mutual fund or private sector mutual fund.**