

Consultation Paper on the framework for platforms providing “execution-only” services in direct plans of Mutual Funds

I. Background

1. To facilitate growth and cost-effectiveness of mutual fund products, in the year 2012, SEBI mandated Mutual Funds (MFs)/Assets Management Companies (AMCs) to provide a separate plan for direct investments, i.e. investments not routed through a distributor. Today an investor desirous of investing in Mutual Funds may invest directly i.e., without involving or routing the investment through any distributor/agent in a ‘Direct Plan’ or may choose to do so through the services of a Mutual Fund distributor (MFD) in what is termed as a ‘Regular Plan’.
2. Both direct and regular plans are part of the same scheme of a mutual fund, with the same/common portfolio, and are managed by the same fund manager, but have different expense ratios (i.e., recurring expenses incurred by a MF scheme). Direct plans are intended for investors who prefer to invest directly in a mutual fund scheme without the help of any distributor/agent. Investing in a direct plan is akin to buying a product from the manufacturer directly, whereby the cost to the customer is lower as there is a saving in terms of distribution cost/commission paid to the distributor/agent, which is added back to the returns of the scheme.
3. Further, to promote the adoption of technology and ease of doing business in the MF Industry, SEBI has undertaken various initiatives, which are broadly summarized as under:
 - a) Vide circular no. CIR/MRD/DSA/32/2013 dated October 04, 2013, mutual fund distributors were permitted to use recognized Stock Exchanges’ infrastructure to facilitate purchase and redemption of mutual fund units by their clients. In the year 2016, SEBI allowed SEBI registered Investment Advisors (IA) also to use the infrastructure of the recognized Stock Exchanges to facilitate purchase and redemption of mutual fund units by their clients.
 - b) In the year 2020, direct access to the infrastructure of recognized Stock Exchanges was facilitated to investors to purchase and redeem mutual fund units.
 - c) Vide circular dated July 26, 2021, a framework for Registrar and Transfer Agents of Mutual Funds (RTA) and Depositories inter-operable platform viz. MF Central was introduced for enhancing investors’ experience in Mutual Fund transactions/service requests.
4. Presently, there are various channels available to investors for investment in direct plans of MF schemes, which include the following: -
 - through the office/website/mobile app of the AMC, in physical or digital mode.

- through SEBI registered Stock Broker (SB)/Investment Adviser (IA)/Portfolio Manager(PM) in digital mode using Mutual Fund transaction platform provided by Stock Exchanges viz. NMF Platform and BSE StAR MF.
 - through SEBI registered IA/PM directly with AMCs as their clients.
 - through platforms like MF Utilities India Pvt. Ltd., MF Central, etc.
5. MF industry has seen tremendous growth in the past decade and as on April 30, 2022, the Asset Under Management (AUM) of the Mutual Fund industry stands at INR 38.04 lakh crore. In a decade since the introduction of a separate plan for direct investments in MFs, investments through direct plans of MF schemes have seen enormous growth. As on April 30, 2022, the AUM routed through direct plans of MFs schemes stands at INR 16.94 lakh crore, which is 45% of the total AUM while the remaining is routed through regular plans of MF schemes. Of the direct plan AUM of MFs, participation by individuals (other than HNIs, HUFs, and NRI) is 11.2%.
 6. Further, the number of Demat accounts almost doubled in the recent past (4.09 crore as on March 31, 2020, to 7.38 crore on October 31, 2021)¹. There has also been a significant rise in the number of unique investors in MFs (from 2.92 crore as on March 31, 2020, to 3.52 crore on October 31, 2021) in the same period. As on March 31, 2022, the number of Demat accounts stands at 8.96 crore and the number of unique investors in MFs stands at 4.12 crore. With the increasing focus on financial literacy, digitization, online banking, usage of smartphones, and awareness about Mutual Funds, more and more investors may be in a better position to leverage technology and invest directly in MF schemes.
 7. It is observed that various SEBI registered IA/SB have been providing execution services in direct plans of MF schemes through their technology platforms/digital platforms. However, not all investors who are executing transactions in direct plans of MF schemes through these platforms are availing of any advisory/broking services. They are rather using the platform only to execute transactions in direct plans of MF schemes. With respect to such investors, IAs/SBs typically use their respective IA/SB registration codes to have the visibility of data feeds of clients' transactions executed through their platform.
 8. In the context of visibility of clients' transaction data feeds, SEBI vide letter² dated September 6, 2021, to the Association of Mutual Funds in India (AMFI), *inter alia* clarified that a SB/non-individual IA/PM can have visibility of clients' direct plan transaction data feeds from RTAs for clients availing advisory/broking/portfolio management services by using the IA/SB/PM codes.
 9. The usage of IA/SB/PM registration code by platforms mentioned at para 7 above for visibility of the transactions brings convenience for investors by providing an overall overview of their investments. However, for the investors who are not their clients in terms of IA/SB/PM Regulations, the risk associated with such transactions cannot be overlooked as the non-clients do not have any

¹ <https://pib.gov.in/PressReleaseFramePage.aspx?PRID=1780999>

² <https://www.amfiindia.com/Themes/Theme1/downloads/circulars/SEBIClarificationw.r.t.transactionsunderDirectPlan.PDF>

recourse or protection available under any regulatory framework. Thus, there is a need to strike balance between the convenience and investor protection.

10. In terms of the provisions of the respective Regulations, for onboarding an investor as client, IAs/SBs/PMs are required to enter into an agreement with the clients or get clients' signatures on rights and obligations documents, for which minimum mandatory terms has been prescribed by SEBI keeping in mind the nature of service provided by IA/SB/PM.
11. The investors routing their mutual fund transactions through such platforms provided by IAs/SBs could find it inconvenient to execute agreements wherein many provisions of agreements / similar documents mandated for IAs / SBs may not be relevant for investors availing execution only services through IAs/SBs for transaction in MFs.
12. Presently, there is no specific framework available for technology platforms/digital platforms (including platforms provided by IAs/SBs to non-clients) to provide execution-only services in direct plans of MF schemes and obtain data feeds with respect to such transactions.
13. Though the platforms provided by Stock Exchanges/RTAs viz, NMF Platform, BSE StAR MF, and MF Central enable the investors to transact directly without availing services of an intermediary, there are considerable number of investors who may find it more convenient to avail the services of technology/digital platforms provided by IAs/SBs for transactions in mutual fund schemes of different AMCs.
14. Hence, to further promote the penetration of MFs and to ensure that ease of investment comes with adequate investor protection and grievance redressal mechanism, a framework for working of these platforms may be the stepping stone towards strengthening the investors with the power of technology along with the ability to invest directly in MF schemes.
15. The matter was discussed in the Mutual Fund Advisory Committee (MFAC) wherein it was proposed that a separate framework for Execution-Only Platforms (EOPs) can be introduced. Further, the Committee deliberated on various requirements for the proposed framework, which *inter-alia* included the following:
 - Legal structure and regulation of EOPs – Either as an intermediary registered with SEBI (i.e., as an agent of investor) or registered with AMFI as an agent of AMC
 - Framework for EOPs – visibility of client transactions, connectivity with AMCs, client level segregation, data sharing among stakeholders, etc.
 - Revenue model - Fee structure for EOPs as an agent of AMC to be transaction based, a suitable cap can be prescribed on such fees while acting as an agent of investors.
16. Further, feedback was received in this regard from industry participants wherein it was suggested that as SEBI has already enabled investors to

directly access and transact in mutual funds on Stock Exchanges, the latter already have the necessary technology-based infrastructure as well as system and processes in place to facilitate direct transactions in mutual funds electronically for investors investing directly by themselves without relying on MFDs, IAs or SBs. Hence, entities which are presently providing “Execution Only” services should integrate with the Stock Exchange Platforms as one more channel/avenue for investors. It was suggested that the Stock Exchanges could easily monitor such EOPs under the existing Stock Exchange platform framework, rules with minimum efforts and also audit the services offered by the EOP platforms periodically as per existing Stock Exchange rules/procedure. For the above purpose, the Stock Exchanges may create a separate limited purpose membership for entities desirous of offering EOP services to the Investors.

II. Proposal

17. Based on the above, the proposed framework for EOPs is as under:

A. Regulation of EOPs

- i. Any of the following legal structures may be considered for bringing EOPs under the regulatory framework:
 - a. **‘Approach 1’**: Mandating EOPs to obtain SEBI registration as an intermediary under separate regulations for EOPs wherein the EOP shall act as an agent of investors by entering into an agreement with each investor with minimum mandatory terms and conditions; OR,
 - b. **‘Approach 2’**: Mandating EOPs to obtain registration from AMFI wherein the EOPs shall act as an agent of an AMC by entering into a contract with the AMCs; OR,
 - c. **‘Approach 3’**: Mandating EOPs to obtain limited purpose membership with Stock Exchanges wherein the EOPs shall act as an agent of investors by entering into an agreement with each investor.
- ii. Thus, an entity desirous of providing execution-only services in direct plans of Mutual Funds may be mandated to act as a registered intermediary or an entity registered with AMFI or an entity with limited purpose membership with Stock Exchanges.
- iii. **Views/ comments sought on:**
 - a. *Which of the approaches (1,2 or 3) is recommended for regulation of the EOPs and the rationale for the same?*
 - b. *Can more than one approach work simultaneously?*

c. *Is the regulatory scope mentioned above adequate? If not, requisite modifications may be suggested.*

d. *Under Approach 1 and 3, what should be the key principles of the agreement between the investor and the EOP?*

B. Scope, eligibility and other requirements for EOPs

- i. **Scope of Service:** EOPs may provide both financial services viz. purchase, redemption of mutual fund units, etc. and non-financial services viz. change of email id/contact number/bank account details, complaints, etc.
- ii. Only a body corporate may be eligible to obtain registration as EOP under SEBI Regulations or as an execution platform with AMFI or to apply for limited purpose membership with Stock Exchanges. Such body corporate may or may not carry out other activities.
- iii. If carrying out other activities as well, EOPs may be required to maintain an arm's length relationship between their activities as EOPs and the other activities by providing EOP services through a separately identifiable EOP department or division.
- iv. Since EOPs mainly operate through digital/technological platforms, additional requirements related to cybersecurity and other relevant parameters for EOPs would need to be prescribed under the Regulations/ by AMFI/by Stock Exchanges.
- v. **Views/ comments sought on:**
 - a. *Whether the proposal to allow EOPs to provide both financial and non-financial services is appropriate?*
 - b. *Whether additional conditions/requirements, if any, apart from cybersecurity-related requirements need to be specified? Suggestions may be given.*
 - c. *What should be the investor related data sharing policy between the EOP department/division and other parts of the body corporate?*
 - d. *If the same entity is allowed to offer EOP services under all three approaches then whether a segregation in terms of manpower, infrastructure etc., should be mandated?*

C. Conditions for registration / limited purpose membership

- i. Irrespective of the regulatory approach adopted for the regulation of EOPs, adequate infrastructure to provide financial and non-financial services shall be a pre-requisite for an EOP as the same indicates seriousness of intent in setting up the business and also inspires confidence. As the investors would be relying on EOPs to execute Mutual Fund transactions, in order to ensure

continuity and provide assurance to investors that the entity is equipped in all respects, it is felt that EOPs need to be adequately capitalized in addition to other infrastructure requirements.

ii. **Net worth requirements:** It is felt that the minimum net worth should be prescribed in such a manner that it is not prohibitively high to deter small serious players or be anti-competitive.

a. **Under Approach 1** – EOP may be mandated to have a minimum net worth which would ensure capital commensurate with the required scale of operations and infrastructure and future growth projections.

b. **Under Approaches 2 & 3** – AMFI and Stock Exchanges may prescribe minimum capital requirements for EOPs on similar lines as under Approach 1 to register or provide limited purpose membership with them respectively.

iii. **Infrastructure and Manpower:**

a. **Under Approach 1** - The IOSCO Standard for Market Intermediaries requires that intermediaries should comply with standards for internal organisation and operational conduct that aim to protect the interest of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.

Considering the technology-driven approach of EOP business, adequate checks and balances with respect to cybersecurity, data processing, and data privacy become important. Therefore, under Approach 1, an EOP may be required to have adequate infrastructure which may include, but not limited to, appropriate technological, operational, legal, and financial systems and resources.

b. **Under Approach 2 & 3:** AMFI and Stock Exchanges may devise minimum requirements for EOPs on similar lines as under Approach 1 to register or to provide limited purpose membership with them respectively.

iv. **Fit & Proper criteria**

a. **Under Approach 1** - EOPs would need to be in compliance with the 'fit and proper person' criteria as prescribed in Schedule II of SEBI (Intermediaries) Regulations, 2008.

b. **Under Approach 2** - AMFI and Stock Exchanges may devise minimum requirements for EOPs on similar lines as under Approach 1, to register or to provide limited purpose membership with them respectively.

v. **Views/ comments sought on:**

- *Whether additional conditions/requirements, if any, need to be specified? For instance, minimum qualifications/experience of promoters and key management personnel. Suggestions may be given.*

D. General obligations and responsibilities

i. **Visibility of client transactions:** The EOP may have the 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.

ii. **Use of client data (Data Sharing):**

- a. **Under Approach 1:** As an agent of investor, EOP may use the data of the execution-only client for all legal purposes in line with the agreement with the client.
- b. **Under Approach 2:** EOP to use the client's data as per terms of the contract with AMCs or as per AMFI guidelines on the same.
- c. **Under Approach 3:** As an agent of investor, EOP may use the data of the execution-only client for all legal purposes in line with the agreement with the client.

iii. **Agreement with AMCs:**

- a. **Under Approaches 1 & 2:** The EOP may enter into a contractual agreement with AMCs or RTAs/Depositories (if so authorized by an AMC) to integrate their systems and to provide execution services in direct plans of MFs.
- b. **Under Approach 3:** The EOP may enter into a contractual agreement with Stock Exchanges to integrate their systems and to provide execution services in direct plans of MFs. In turn, the Stock Exchanges have a contractual agreement with the AMCs or RTAs /Depositories (if so authorized by an AMC).

iv. **Client Level Segregation:** EOPs may be mandated to ensure client level segregation w.r.t their activities as EOP, IA/SB/PM and MFD activities.

v. **Fees**

- a. **Under Approaches 1 and 3:** EOPs may receive transaction-based fees only from the clients and no consideration may be received from AMCs.
- b. **Under Approach 2:** EOPs may receive payments transaction-based fees only from AMCs and in the manner specified by AMFI.

vi. **Views/ comments sought on**

- a. *Whether the proposed norms relating to general obligations and responsibilities of EOPs are adequate?*
- b. *Whether an upper limit(s) be prescribed for a transaction-based fee under Approach 1 and 3 (i.e., for the lump sum transaction, SIP transaction and for non-financial transactions)?*

- c. *Should data sharing be permitted among EOP, MFD and IA/SB/PM divisions of a body corporate?*
- d. *If the same entity is allowed to offer EOP services under all three approaches then whether the following should be mandated:*
 - i. *client level segregation among its activities as EOP under different approaches?*
 - ii. *AMC level segregation i.e., the product of one AMC can only be offered under one approach?*

E. Transparency and Grievance Redressal

i. Client onboarding:

- a. **Under Approach 1 and 3:** Mandatory agreement or terms and conditions document may be entered into between EOP and client at the time of onboarding. EOP shall be responsible for ensuring compliance with KYC requirements applicable for onboarding an investor for investment in MFs.
- b. **Under Approach 2:** There may be no requirement of agreement between investor and EOP. Investors can be on boarded by complying with the required KYC process and verification as applicable for all MF investors including MFD clients. However, AMCs shall be responsible for ensuring compliance with KYC requirements applicable for onboarding an investor for investment in MFs.

ii. Grievance redressal mechanism:

- a. **Under Approach 1:** Grievance redressal mechanism can be similar to as prescribed for other SEBI registered intermediaries (through SCORES).
- b. **Under Approach 2:** Grievance redressal mechanism can be similar to as prescribed for MFDs wherein AMC shall monitor the activities of EOPs to ensure compliance with code of conduct and other guidelines. In case of any instance of material breach of adherence to applicable guidelines, the concerned AMC shall report the same to AMFI and SEBI. Any complaint against EOP shall be examined and dealt with by AMFI in similar manner as applicable for MFDs, which may result in action against proposed EOP, if it so warrants.
- c. **Under Approach 3:** Grievance redressal mechanism can be as prescribed by Stock Exchanges in consultation with SEBI

iii. Views/ comments sought on

- a. *Whether the proposed norms relating to transparency and grievance redressal are adequate?*

- b. *Whether additional conditions/requirements, if any, need to be specified?
Suggestions may be given.*

F. Any other suggestions regarding the overall framework for EOPs.

Public Comments on the Consultation Paper on the framework for platforms providing “execution-only” services in direct plans of Mutual Funds

1. Considering the implications of the said matter on the market participants, public comments are invited on the proposal. The comments/ suggestions may be provided as per the format given below:

| Name of the person/entity proposing comments: | | | | |
|---|---------------------------------|---|-----------------------|-----------|
| Name of the organization (if applicable): | | | | |
| Contact details: | | | | |
| Category: whether market intermediary/ participant (mention type/ category) or public (investor, academican etc.) | | | | |
| Sr. No. | Extract from Consultation Paper | Issues (with page/para nos., if applicable) | Proposals/Suggestions | Rationale |
| | | | | |

Kindly mention the subject of the communication as, “Comments on Consultation paper on framework for platforms providing “execution only” services in direct plans of Mutual Funds”.

Comments as per aforesaid format may be sent to the following, latest by August 12, 2022, (within 21 calendar days from the date of publication of this consultation paper on SEBI website) through the following modes :

- a. Preferably by email to: eop@sebi.gov.in; or
- b. By post to the following address:

Manaswini Mahapatra,
General Manager,
Investment Management Department,
Securities and Exchange Board of India,
SEBI Bhavan, C4-A, G-Block,
Bandra Kurla Complex, Bandra (East),
Mumbai – 400051

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(End of Consultation Paper)