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PMS managers use 'trust' route to lure clients

Mehul Shah / Mumbai November 9, 2011, 0:56 IST

Portfolio managers find a way to get over bar on pooling clients' money, impose lock-in.

Portfolio managers are using a 'trust structure' to attract clients in their schemes, allowing them to overcome the regulatory hurdles that bar pooling of clients' accounts and to specify a lock-in period.

In this structure, used by the Portfolio Management Services (PMS) divisions of some brokerages, a private trust is organised by a sponsor. The trust signs an agreement with the PMS manager. It also appoints a trustee company to ensure the objectives of the trust are met. Investors will put money in the trust, which in turn becomes a client of the PMS manager for a particular strategy. The entry and exit of the investors will be through the trust.

HOW THE 'TRUST' STRUCTURE WORKS

- A sponsor organises a private trust, which signs an agreement with the PMS manager
- Trust appoints a trustee company to ensure that the objectives of the trust are met
- Investors put money in the trust, which, in turn, becomes a client of the PMS manager for a particular strategy
- Entry and exit of investors is through the trust. It works like a close-ended scheme for investors, with a lock-in period of 3-5 years
- This structure makes sense for private-equity type of investments

This, then, works like a close-ended scheme. There is a pre-determined lock-in, say three to five years, for investors. Investors have to pay 2-2.5 per cent yearly to the trust, of which 1.5-2 per cent is given to the PMS manager as fees; the rest is for expenses.

"There are certain strategies that require pooling of accounts, which is not allowed under the PMS regulations. By using trust structures, PMS divisions of broking firms can create a pooling," said Siddharth Shah, head of the corporate and securities practice group at law firm Nishith Desai Associates. "The other advantage is that PMS managers may possibly get better tax treatment on performance profits for managing the units of a trust, as such distribution can be by way of return on units held by them in the trust as against fee income."

By the Securities and Exchange Board of India (Sebi) norms, a portfolio manager is required to segregate each client's funds and portfolio of securities, keeping these separate from own funds and securities. In the trust structure, pooling of clients' accounts is possible, as the entry and exit of investors is through the trust and not the PMS scheme.

Also in this structure, as the trust is a client of the PMS manager, there is no requirement to do a separate KYC check, billing and book keeping for each individual investor.

This structure, in which there is a lock-in period for investors, makes sense for

private equity-type of investments, experts say. "Certain strategies require lock-in from investors which a PMS scheme does not permit but can be achieved through a trust structure," Shah said. Sebi norms say portfolio managers cannot impose a lock-in on the investment of their clients.

These trusts will have to be registered with Sebi as and when the new regulations on alternative investment funds' (AIFs) come, experts say. Under the proposed AIF regulations, Sebi aims to frame norms to register and regulate the formation of investment funds which raise capital from a number of high net-worth investors with a view to investing in accordance with a defined investment policy.