Corpsec Hotline

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POOLING OF RETAIL INVESTORS UNDER PORTFOLIO MANAGERS REGULATIONS NOW DIFFICULT!

The Securities and Exchange Board of India ("**SEBI**") has vide SEBI (Portfolio Managers) (Amendment) Regulations, 2012 ("**Amendment Regulations**") dated February 10, 2012 amended the SEBI (Portfolio Managers) Regulations, 1993 ("**PM Regulations**") primarily on the following counts: (i) increasing the minimum investment amount per client from INR 5 lakhs to INR 25 lakhs; and (ii) ensuring segregation of holdings per client in case of investments in unlisted securities.

BACKGROUND

The SEBI had in its board meeting held on January 28, 2012[1] decided to make inter alia the abovementioned changes in the PM Regulations.

Earlier, in 2008, SEBI vide SEBI (Portfolio Managers) (Amendment) Regulations, 2008, revised Regulation 16(8) of the PM Regulations requiring segregation of individual client holdings in case of investments through portfolio managers in listed securities.[2]

In 2011, the SEBI issued a Concept Paper along with the draft SEBI (Alternative Investment Funds) Regulations, 2011 ("**Draft Regulations**"), wherein SEBI proposed to regulate portfolio managers who intend to 'pool' assets for investments into unlisted securities.

SEBI in its Concept Paper highlighted the fact that even after being made mandatory for portfolio managers to segregate client accounts, the services provided by many portfolio managers were standardized portfolio strategies where assets of clients were handled without customization, leading to proxy fund management, akin to mutual funds.

Further, SEBI also observed that the minimum investment of INR 5 lakhs made the products accessible to retail investors without protection which are available to retail investor under the mutual fund framework.

Therefore, the Concept Paper proposed that:

1. The minimum investment amount per client for availing portfolio management services be increased to INR 25 lakhs; and
2. All portfolio managers who seek to pool assets such as for investing in unlisted securities would be required to register such pooling schemes as an alternative investment fund.

THE CHANGE

Vide the Amendment Regulations, the SEBI has introduced the following changes to the PM Regulati

- **Minimum investment limits :** The SEBI has enhanced the minimum investment amount per client from INR 5 lakhs to INR 25 lakhs. However, it has clarified that (i) this minimum investment amount per client would be applicable for new clients and fresh investments by existing clients; and (ii) existing investments of clients, as on date of notification of the Amendment Regulations may continue until maturity of the investment.
- **Segregation of holding in case of unlisted securities :** A portfolio manager now has to ensure segregation of individual client holdings in case of investments in unlisted securities. However, SEBI has clarified that (i) segregation of each client's holding in unlisted securities shall be applicable only in respect of investment by new clients and fresh investments by existing clients; and (ii) existing investments in unlisted securities of clients, as on date of notification of the Amendment Regulations may be held in a pooled manner until maturity of such investments.
- **Signature in Disclosure Document :** The disclosure document now needs to be signed by at least two directors of the portfolio manager, instead of all the directors of the portfolio manager.

ANALYSIS AND CONCLUSION

The first two changes seem to have followed from the Concept Paper which talks about (i) minimum higher investment limits and (ii) segregate the clients' funds and prohibition on pooling of funds / securities of clients

Though, the reason for the increase of the investment limit by SEBI may have been made with the intention of protecting the retail investors who have access to these products but not the protection which otherwise would be available under the mutual fund framework, a higher investment limit may also preclude a large number of informed retail investors who intend to avail of portfolio management services.

Also, since now the holdings per client in case of investments in unlisted securities will also have to be segregated, a

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portfolio manager with more than 50 clients may henceforth not be able to invest in the shares of a private company as the number of shareholders in a private company is limited to 50. SEBI's intention, as it appears from the Concept Paper and this Amendment Regulations, is to gear any pooling of investments towards alternate investment fund framework.

Further, as regards subscription to debentures by a portfolio manager with 50 or more clients, it is unclear as to whether such subscription would trigger the 'public issue' provisions under the Companies Act, 1956 requiring the target company to issue a prospectus etc.

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You can direct your queries or comments to the authors

[1] The SEBI press release PR No. 15/2012, http://www.sebi.gov.in/cms/sebi_data/pdffiles/22979_t.pdf

[2] Revised Regulation 16(8) reads as follows: "portfolio manager shall not hold the listed securities, belonging to the portfolio account, in its own name on behalf of its clients either by virtue of contract with clients or otherwise

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