CHAPTER 4
REGULATORY FRAMEWORK GOVERNING MUTUAL FUNDS

The need to regulate mutual funds industry arose from the very objective of setting up of these outfits. The main objectives of mutual funds industry have been two-fold: to protect investors’ interest by following sound fund management policy and to act as a via media to channelise investors’ resources to the most productive area through the capital market route. Further, since mutual funds market operations involve buying/selling/holding various listed scrips or debt instruments, they have a significant impact on savings, investment, liquidity and the overall status of the financial markets. The very market structure of the industry also necessitates its own regulation. The entry of the private sector into the industry has increased the chances of speculative activities. Stock prices may be distorted by such activities unless regulated. All these meant that the growth of the mutual fund industry should also be accompanied by the development of a suitable regulatory framework for it.

The mutual fund regulations should meet the following objectives:

1. To ensure that the mutual funds are managed for the benefits of the investors;
2. To establish confidence among the investors that the funds pooled are invested with some spelt-out investment objectives and policies and protect the physical integrity of the assets;
3. To assure that investors receive adequate and accurate information about their investment;
4. To ascertain that funds should not become the instruments for the benefit of the sponsor encouraging the self dealing and affiliated party transaction by using their privileged position and
5. To formulate rules for accurate and fair valuation of investments, net asset value, repurchase price and redemption price.

The SEBI guidelines basically dealt with three aspects: establishment, operation, and discipline. The establishment of mutual funds required norms for registration, constitution and management of mutual funds. Operational guidelines covered issues relating to schemes of mutual funds, investment objectives and restrictions and
valuation policies. The much needed disciplinary aspect incorporated a number of things including inspection and disciplinary procedures. The SEBI regulations require all mutual funds to be set up as trusts, setting up of Board of trustees and appointment of a separate custodian. The guidelines lay down specific authorization criteria for the sponsors of mutual funds and establishment of a separate asset management company. The business activities of the asset management companies (AMCs) are restricted and there are limitations for the asset management companies in charging the expenses for the schemes. The regulations also provide for stringent accounting and disclosure norms and reporting requirements by the asset management companies. SEBI, as the regulatory body, enjoys the freedom of inspecting a mutual fund and take action against it for any violation of any provision of the regulations.

4.1 ORGANISATION OF A MUTUAL FUND

![Figure 4.1](www.amfiindia.com)
4.2 SEBI (MUTUAL FUNDS) REGULATIONS, 1996\textsuperscript{1}

The Securities and Exchange Board of India (SEBI) issued the Securities and Exchange Board of India (Mutual Funds) Regulation 1996\textsuperscript{2}, which repealed the mutual funds regulations issued in 1993. The 1996 regulations are more comprehensive and outline the regulatory norms for the formation, operation and management of mutual funds. These regulations also clearly lay down the guidelines on investment valuations, investment restrictions, advertisement code and code of conduct for mutual funds and assets management companies. These regulations have been amended from time to time. All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspection by SEBI. The revised regulations provide for:

- Enhanced level of investors’ protection;
- Empowerment of investors’;
- Stringent disclosure norms in the offer documents so that investors are better informed, better advised, better aware of risks and rewards;
- Standardization of norms for valuation of assets, computation of net asset value (NAV) of schemes of mutual funds and accounting standards and policies;
- Removal of quantitative restrictions on investment by mutual funds and replacement by prudential supervision;
- Better governance of mutual fund through higher responsibilities and empowerment of trustees as front-line regulators of mutual funds and
- Code of ethics for asset management companies.

It includes the following aspects, some of which are also discussed in details.

4.2.1 Registration of mutual fund
4.2.2 Constitution and management of mutual fund and operation of trustees, etc.
4.2.3 Constitution and management of asset management company and custodian

\textsuperscript{1} Include amendments up to 2011
\textsuperscript{2} www.sebi.gov.in
4.2.1 Registration of Mutual Fund

- An application for registration of a mutual fund shall be made to the Board in Form A by the sponsor.
- Application for registration under regulation 3 may be made by the sponsor in the prescribed Performa accompanied by a non-refundable application fee as specified in the Second Schedule.
- An application, which is not complete in all respects, shall be liable to be rejected. Provided that, before rejecting any such application, the applicant shall be given an opportunity to complete such formalities within such time as may be specified by the Board.
- Registration will be granted by the Board on fulfillment of the following criteria. The sponsor should have a sound track-record and general reputation of fairness and integrity in all his business transactions. This means that the sponsor should have been doing business in financial services for not less than five years, with positive net worth in all the immediately preceding five years. The net worth of the immediately preceding year should be more than the capital contribution of the sponsor in asset management company and the sponsor should have profit after providing for depreciation, interest and tax for three out of the immediately preceding five years, including the fifth year.
- In the case of an existing mutual fund, such fund should be in the form of a trust and the trust deed should have been approved by the Board.
- The sponsor should contribute at least 40 per cent of the net worth of the asset management company.
- The sponsor or any of its directors or principal officer to be employed by the mutual fund should not have been found guilty of fraud or convicted of an offence involving moral turpitude or guilty of economic offence.
The appointment of trustees and asset management company to manage the affairs of mutual fund and operate the schemes of the fund and a custodian to keep custody of securities or gold and gold related instrument or other assets of the mutual fund held in terms of these related regulations are to be undertaken.

The trustees, the sponsor, the asset management company and the custodian shall comply with the provisions of these regulations.

The mutual fund shall forthwith inform the Board, if any information or particulars previously submitted to the Board was misleading or false in any material respect.

Every mutual fund will pay before the 15th April each year an annual fee as specified in the Second Schedule for every financial year from the year following the year of registration.

The Board may not permit a mutual fund that has not paid annual fee to launch any scheme.

4.2.2 Constitution and Management of Mutual Fund and Operation of Trustees, etc.

A mutual fund shall be constituted in the form of a trust and the instrument of trust shall be in the form of a deed and registered under the provisions of Indian Registration Act, 1908 (16 of 1908), executed by the sponsor in favour of the trustees.

The trust deed shall contain the provisions laid down by SEBI. It should contain such clauses which are necessary for safeguarding the interests of the unit holders.

A mutual fund shall appoint trustees in accordance with these regulations. A trustee should be a person of ability, integrity and standing and should not have been found guilty of moral turpitude or been convicted of any economic offence or violation of any securities law.

No asset management company and no director (including independent director), officer or employee of an asset management company shall be eligible to be appointed as a trustee of any mutual fund.
• A person who is appointed as a trustee of a mutual fund shall not be eligible to be appointed as a trustee of any other mutual fund.
• At least two-thirds of the trustees shall be independent persons and shall not be associated with the sponsors or be associated with them in any manner whatsoever.
• In case a company is appointed as a trustee then its directors can act as trustees of any other trust provided that the object of the trust is not in conflict with the object of the mutual fund.
• The trustees and the asset management company, with Board’s prior approval, shall enter into an investment management agreement which should contain the clauses mentioned in the Fourth Schedule and such other clauses as are necessary for the purpose of making investments.
• The trustees have the right to obtain necessary information from the asset management company.
• The trustees shall ensure before the launch of a scheme that the asset management company has its back-office, dealing room and accounting system in place and that key personnel, auditors and registrars are appointed. They have also to ensure that the compliance manual has been prepared, an internal control mechanism including internal audit systems has been designed and norms have been specified for empanelment of brokers and marketing agents.
• The trustees shall ensure that the asset management company has been diligent in monitoring securities transactions with brokers and avoiding undue concentration of business with any broker and that it has not given undue or unfair advantage to any associate in any manner detrimental to the interest of the unit holders.
• The trustees shall ensure that the asset management company has been managing the schemes independently of other activities and adequate steps have been taken to ensure the interest of investors. They should also ensure that all the activities of the asset management company are in accordance with the provisions of these regulations. They should also take remedial steps if the conduct of business of a mutual fund is not in accordance with SEBI.
regulations and inform the Board of the violation and the action taken by them.

- Each trustee shall file the details of his transactions of dealing in securities with the mutual fund on a quarterly basis.

- The trustee shall be accountable for and be the custodian of funds/property of respective schemes. They should be responsible for the calculation of any income due to be paid to the mutual fund and also of any income received in the mutual fund for the holders of the units of any scheme.

- The trustees shall obtain the consent of the unit holders whenever the Board requires the same in the interests of the unit holders or upon a requisition made by three-fourths of the unit holders of any schemes or if a majority of trustees decides to wind up or prematurely redeem the units.

- In the event of any change in the fundamental attributes of any schemes or the trust or fees or expenses payable or any other change which would modify the scheme and affect the interests of unit holders, the trustee will inform the unit holder and would give an option to exit at the prevailing net asset value without any exit load.

- The trustee shall call for the detail of transactions in securities by the key personnel of the asset management company in his own name or on behalf of the asset management company and shall report to the Board as and when required.

- The trustees shall quarterly review all transactions carried out between the mutual funds and asset management company.

- The trustee shall quarterly review the networth of the asset management company and periodically review all the service contracts such as custody arrangements, transfer agency of securities, etc. and satisfy that such contracts are executed in the interest of the unit holders.

- The trustees shall ensure that there is no conflict of interest between the manner of deployment of its networth by the asset management company and the interest of the unit-holders.

- The trustees shall periodically review the investors’ complaints received and redressal of the same by asset management company.
• The trustees shall abide by the code of conduct as specified in the Fifth Schedule.
• The trustees shall furnish to the Board on a half-yearly basis, a report on the activities of the mutual fund and a certificate stating that they have satisfied themselves that there have been no instances of self-dealing or front running by any of the trustees, directors and key personnel of the asset management company.
• The trustees shall exercise due diligence as under:
  
  ▪ **A. General Due Diligence**

  ▪ The trustees shall be discerning in the appointment of the directors on the Board of the asset management company.
  ▪ Trustees shall review the desirability or continuance of the asset management company if substantial irregularities are observed in any of the schemes and shall not allow the asset management company to float new schemes.
  ▪ The trustees shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons.
  ▪ The trustee shall ensure that all service providers are holding appropriate registration from the Board or concerned regulatory authority.
  ▪ The trustees shall arrange for test checks of service contracts.
  ▪ The trustees shall immediately report to the Board of any special developments in the mutual fund.

  ▪ **B. Specific Due Diligence**

  ▪ The trustee shall obtain internal audit reports at regular intervals from independent auditors appointed by the trustees.
  ▪ The trustees will hold meeting of trustees more frequently.
  ▪ The trustees will obtain compliance certificates at regular intervals from the asset management company.
  ▪ The trustees will consider the reports of the independent auditor and compliance reports of asset management company at the meeting of trustees for appropriate actions.
The trustees will maintain records of the decisions of the trustees at their meeting and of the minutes of the meetings.

The trustees will adhere to a code of ethics by the trustees, asset management company and its personnel.

The trustee shall not be held liable for acts done in good faith if they have exercised adequate due diligence honestly. The independent directors of the trustees or asset management company shall pay specific attention to the following:

- the investment management agreement;
- service contracts with affiliates—whether the asset management company has charged higher fees than outside contractor for the same service;
- selection of the asset management company’s independent directors;
- code of ethics designed to prevent fraudulent practices by insiders in connection with personal securities transactions and
- principal underwriting contracts and their renewals.

4.2.3 Constitution and Management of Asset Management Company and Custodian

- For approval of asset management company, an application shall be made in Form D. For grant of approval of asset management company, in case it is an existing asset management company it should have a sound track-record, general reputation and fairness in transactions.
- The sponsor or trustee (if authorised by the trust deed) shall appoint an asset management company with SEBI’s approval.
- The appointment of an asset management company can be terminated by majority of the trustees or by seventy-five per cent of the unit holders of the scheme.
- Any change in the appointment of the asset management company shall be subject to the prior approval of the Board and the unit holders.
- The directors of the asset management company should have adequate professional experience in finance and financial services related field and should not have been found guilty of moral turpitude, or convicted of any economic offence or violation of any securities law.
• At least fifty per cent of the directors of the Board of directors of the asset management company should not be associated with the sponsor or any of its subsidiaries or the trustees.
• The chairman of the asset management company should not be a trustee of any other mutual fund.
• The asset management company shall have a minimum net worth of Rs.10 crores (i.e. aggregate of the paid up capital and free reserves of the company after deducting miscellaneous expenditure to the extent not written off or adjusted or deferred revenue expenditure, intangible assets and accumulated losses).
• No directors of an asset management company shall hold the position of a director in another asset management company unless such person is an independent director and approval has been obtained from the Board of asset management company of which such person is a director.
• No change in the controlling interest of asset management company shall be made unless prior approval of trustees and the Board is obtained. Information is given to each unit holder and option is given to them to exit on the prevailing net asset value without any exit load.
• Asset management company shall inform the Board of any material change in the information or particulars previously furnished which have a bearing on the approval granted by it.
• No appointment of a director of an asset management company shall be made without prior approval of the trustees.
• Asset management company shall furnish such information and documents to the trustees as and when required by the trustees.
• The asset management company shall not act as a trustee of any other mutual fund or undertake any other business activities except activities in the nature of management and advisory services to offshore funds, pension funds, provident funds, venture capital funds, management of insurance funds, financial consultancy and exchange of research on a commercial basis if any of such activities are not in conflict with the activities of the mutual fund. Provided that the asset management company may itself or through its subsidiaries undertake such activities, as permitted under clause (b), if,
- It satisfies the Board that bank and securities accounts are segregated activity wise.
- It meets with capital adequacy requirements, if any, separately for each such activity and obtains separate approval if necessary under the relevant regulations.
- It ensures that there is no material conflict of interest across different activities.
- The absence of conflict of interest shall be disclosed to trustees and unit holders in scheme information document and statement of additional information.
- There are unavoidable conflict of interest situations, it shall satisfy itself that disclosures are made of source of conflict, potential ‘material risk and damage’ to investors’ interests and detailed parameter for the same.
- It appoints separate fund manager for each separate fund managed by it unless the investment objective and asset allocation are same and the portfolio is replicated across all the funds managed by the fund manager, within a period of six months from the notification of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulation, 2011.
- It ensures fair treatment of investors across different products that shall include, but not limited to, simultaneous buy and sell in same equity security only through market mechanism and a written trade order management system.
- It ensures independence to key personnel handling the relevant conflict of interest is provided through removal of direct link between remuneration to relevant asset management company personnel and revenue generated by that activity.

Provided further that asset management company may itself or through its subsidiaries, undertake portfolio management service and advisory services for other than broad based funds (i.e. funds which has at least twenty investors’ and no single investor account for more than twenty five per cent of corpus of the fund) as may be specified by the Board with the following additional conditions:
• It satisfies that key personnel of the asset management company, the system, back office, bank and security accounts are segregated activity-wise and there exists system to prohibit access to inside information of various activities.
• It meets with the capital adequacy norms, if any, separately for each of such activities and obtains separate approval, if necessary under the relevant regulations.
• The asset management company shall not invest in any of its schemes unless full disclosure of its intention to invest has been made in the offer documents, in case of schemes launched after the notification of Securities and Exchange Board of India (Mutual Funds)(Amendment )Regulation, 2011.
• The asset management company shall not carry out its operations including trading desk, unit holder servicing and investment operation outside the territory of India. Provided asset management company having any of its operation outside India shall wind up and bring them within the territory of India within a period of one year from the date of notification of Securities and Exchange Board of India (Mutual Funds)(Amendment ) Regulation, 2011.

**Obligation of an Asset Management Company**

• The asset management company shall take all reasonable steps and exercise due diligence to ensure that investment of funds pertaining to any scheme is not contrary to the provisions of these regulations and the trust deed.
• The asset management company shall exercise due diligence and care in all its investment decisions as would be exercised by other person engaged in the same business. The asset management company shall be responsible for the acts of commission or omission by its employees or the persons whose services have been procured by the asset management company.
• An asset management company shall submit to the trustees quarterly reports of each year on its activities and the compliance with these regulations.
• The trustees at the request of the asset management company may terminate the assignment of the asset management company.
• An asset management company shall not through any broker associated with the sponsor, purchase or sell securities, which is average of 5 per cent or more
of the aggregate purchase and sale of securities made by the mutual fund in all its schemes.

- An asset management company shall not utilise the services of the sponsor or any of its associates, employees or their relatives for the purpose of any securities transaction and distribution and sales of securities unless disclosure is made to the unit holders and the brokerage/commission paid is disclosed in half-yearly annual accounts of the mutual fund.

- In case any company has invested more than 5 per cent of the net asset value of a scheme, the investment made by that scheme or by any other scheme of the same mutual fund in that company or its subsidiaries shall be brought to the notice of the trustees by asset management company and be disclosed in the half-yearly and annual accounts of the respective schemes with justification for such investment.

- The asset management company shall file with the trustees and the Board-detailed bio-data of all its directors along with their interest in other companies within fifteen days of their appointment; any change in the interest of directors every six month; a quarterly report to the trustees giving details and adequate justification about the purchase and sale of the securities of the group companies of the sponsor or the asset management company, as the case may be, by the mutual fund during the said quarter.

- Each director of the asset management company shall file the detail of his transactions of dealing in securities with the trustees on a quarterly basis in accordance with the guidelines issued by the Board.

- No person should be appointed as key personnel who has been found guilty of any economic offence or involved in violation of securities law.

- The registrar and share transfer agents to be appointed by asset management company are to be registered with SEBI.

- The asset management company shall abide by the code of conduct as specified in the Fifth Schedule.
Appointment of Custodian

- The mutual fund shall appoint a custodian to carry out the custodian services for the scheme of the fund and send intimation of the same to the Board within fifteen days of the appointment of the Custodian.
- A custodian in which the sponsor or its associates holds 50 per cent or more of the voting rights of the share capital of the custodian or where 50 per cent or more of the directors of the custodian represent the interest of sponsor or its associates, cannot act as a custodian.
- A mutual fund shall enter into a custodian agreement with the custodian which shall contain clauses which are necessary for the efficient and orderly conduct of the affairs of custodian. The agreement of the custodian shall be entered into with the prior approval of the trustees.

4.2.4 Schemes of Mutual Funds

- All the schemes to be launched by the asset management company need to be approved by the trustees and copies of offer document of such schemes are to be filed with SEBI.
- The mutual fund shall pay minimum filing fee (i.e. 0.005 per cent of the amount raised in the new fund offer, subject to a minimum of rupees one lakh and a maximum of rupees fifty lakhs) specified in the Second Schedule to the Board while filing the offer document.
- The offer documents shall contain adequate disclosures to enable the investors to make informed decisions.
- The Board may in the interest of investors require the asset management company to carry out such modifications in the offer document as it deems fit. In case no modifications are suggested by the Board in the offer document within 21 working days from the date of filing, the asset management company may issue the offer document.
- No one shall issue any form of application for units of a mutual fund unless the form is accompanied by the memorandum containing such information as may be specified by the Board.
• The offer document shall contain the disclosure regarding the prior in principle approval obtained from the recognized stock exchange(s) where units are proposed to be listed in accordance with these regulations.

• The asset management company shall provide an option to the unit holder to nominate, in the manner specified in the Fourth Schedule, a person in whom the units held by him shall vest in the event of his death.

• Advertisements in respect of schemes should be in conformity with the SEBI prescribed advertisement code and should disclose investment objectives of each scheme and should be submitted to the Board within 7 days from the date of issue. Advertisement should not contain any statement which is incorrect or false.

• Every close ended schemes other than an equity linked saving scheme shall be listed on a recognized stock exchange within such time period and subject to such condition as specified by the Board. However, listing of close ended schemes launched prior to commencement of SEBI (mutual funds)(Amendment) Regulation, 2009 shall not be mandatory in case the schemes provides for periodic repurchase facilities to all unit holders; if the scheme provides for monthly income or caters to the special classes of persons like senior citizens, women, children, physically handicapped, etc; if the scheme discloses details of repurchase in the offer document; if the scheme opens for repurchase within six months from the closure of subscription; if the said scheme is a capital protection oriented scheme.

• Units of close ended scheme, other than those of equity linked saving scheme, launched on or after the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulation, 2009 shall not be repurchased before the end of maturity period of such scheme.

• Units of a close ended scheme can be opened for sale or redemption at a predetermined fixed interval if the minimum and maximum amounts of sale, redemption of the units and periodicity of such sale have been disclosed in the offer document.

• Units of a close-ended scheme may be rolled over if the purpose, period and other terms of the roll over and all other material details of the scheme including likely composition of assets immediately before the roll over, the net
asset and net asset value of the scheme are disclosed to the unit holders and a copy of the same has been filed with the Board.

- No scheme of a mutual fund other than initial offering period of equity linked saving schemes shall be open for subscription for more than fifteen days.

- The asset management company must specify in the offer document about the minimum subscription and the extent of oversubscription which is intended to be retained. In the case of oversubscription, all applicants applying up to 5,000 units must be given full allotment subject to oversubscription.

- The mutual fund and asset management company must refund the application money within a period of five working days from the date of closure of subscription list if minimum subscription is not received and also the excess of subscription.

- In the event of failure to refund the amount within the period specified, the asset management company shall be liable to pay interest to the applicants at a rate of fifteen per cent per annum from the expiry of five working days from the date of closure of subscription list.

- The asset management company shall issue to the applicant whose application has been accepted, a statement of accounts specifying the number of units allotted to the applicant as soon as possible but not later than five working days from the date of closure of the initial subscription list from the date of receipt of the request from the unit holders in any open ended scheme:
  - Provided if applicant desires, the asset management company shall issue the unit certificate to the applicant within five working days of the receipt of request for the certificate.
  - An applicant in a close ended scheme whose application has been accepted shall have the option either to receive the statement of accounts or to hold units in dematerialized form and asset management company issue statement of accounts specifying the number of units or issue units in dematerialized form as soon as possible but not later than five working days from the date of closure of the initial subscription list.
  - The asset management company shall issue units in dematerialized form to a unit holders in a close ended scheme listed on a recognized
stock exchange within two working days of the receipt of request from
the unit holder.

- The asset management company shall ensure that consolidated account
statement for each calendar month is issued, on or before tenth day of
succeeding month, detailing all the transactions and holding at the end
of the month including transaction charges paid to the distributor,
across all schemes of all mutual funds, to all the investors whose folio
transactions take place during that month. Provided further that the
asset management company shall identify common investor across
fund houses by their permanent account number for the purposes of
sending consolidated account statement.

- A unit unless otherwise restricted or prohibited under the scheme, shall be
freely transferable by act of parties or by operation of law.

- Guaranteed returns can be provided in a scheme if such returns are fully
guaranteed by the asset management company or sponsor. In such cases, there
should be a statement indicating the name of the person and the manner in
which the guarantee is to be made must be stated in the offer document.

- A capital protection oriented scheme may be launched subject to the
following:

  - the units of the scheme are rated by a registered credit rating agency
  - the scheme is close ended
  - there is compliance with such other requirements as may be specified
    by the Board in this behalf.

- A close-ended scheme shall be wound up on redemption date, unless it is
rolled over; or if 75 per cent of the unit holders of a scheme pass a resolution
for winding up of the scheme; if the trustees, on the happening of any event,
require the scheme to be wounded up; or if SEBI so directs in the interest of
investors.

- Trustees shall give notice disclosing the circumstances leading to the winding
up of the scheme in two daily newspapers having circulation all over India and
a vernacular newspaper circulating at the place where the mutual fund is formed.

- The trustees or asset management company shall cease to carry on any business activities in respect of the scheme so wound up; redeem units in the scheme.
- The trustee shall dispose of the assets of the scheme concerned in the best interest of the unit holders of that scheme. The trustee shall forward to the Board and the unit holders a report on the winding up, steps taken for disposal of assets of the fund before winding up, expenses of the fund for winding up, net assets available for distribution to the unit holders and a certificate from the auditors of the fund.
- Units of a mutual fund scheme shall be delisted from a recognized stock exchange in accordance with the guidelines as may be specified by the Board.

4.2.5 Investment Objectives and Valuation Policies

- The money collected under any scheme shall be invested in securities, money market instruments, privately placed debentures, securitized debt, gold or gold related instruments and real estate assets in accordance with the investment objective of the relevant mutual fund scheme.
- The mutual fund having an aggregate of securities which are worth Rs. 10 crores or more as on the latest balance-sheet date, shall subject to such instructions as may be issued from time to time by the Board to settle their transactions entered on or after January 15, 1998 only through dematerialized securities.
- The mutual fund can borrow upto 20 per cent of the net assets of the scheme for duration of up to six months to meet temporary liquidity needs of repurchase, redemption of units, or payment of interest or dividend to unit holders.
- Mutual fund shall not advance any loans for any purpose. A mutual fund may lend and borrow securities in accordance with the framework relating to short selling and securities lending and borrowing specified by the Board.
- The funds of a scheme shall not in any manner be used in carry forward transactions. Provided that a mutual fund may enter into derivative
transactions on a recognized stock exchange subject to the framework specified by the Board.

- Mutual funds may enter into underwriting agreement after obtaining a certificate of registration from SEBI (Underwriters). For the purpose of underwriting, capital adequacy norms shall be the net assets of the scheme. However, the underwriting obligation of a mutual fund should not exceed the total NAV of the scheme.

- Every mutual fund shall compute the net asset value of each scheme by dividing the net assets of the scheme by the number of units outstanding on the valuation date. The NAV of the scheme shall be calculated and published at least in two daily newspapers at intervals of not exceeding one week. Provided that NAV of close ended scheme, other than that of equity linked saving scheme, shall be calculated on daily basis and published in at least two daily newspapers having circulation all over India.

- A mutual fund, in case of open-ended scheme shall periodically publish the sale and repurchase price of units at least once in a week in a daily newspaper of all-India circulation

- A mutual fund should ensure that repurchase price is not lower than 93 per cent of the NAV and sale price is not higher than 107 per cent of the NAV. Provided that the repurchase price of the units of close ended scheme launched prior to the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2009 shall not be lower than ninety five per cent of the Net Asset Value.

- The difference between the repurchase and sale price shall not exceed 7 per cent calculated on the sale price.

4.2.6 General Obligations

The asset management company shall maintain for each scheme proper books of accounts, records and documents and disclose at any point of time the financial position of each scheme and give a true and fair view of the state of affairs of the fund and shall intimate to the Board the place where such books of accounts, records and documents are maintained. Every asset management company will maintain and preserve for a period of eight years its books of accounts, records and documents. The
asset management company will follow the accounting policies and standards as specified in the Ninth Schedule so as to provide appropriate details of the scheme-wise disposition of the assets of the fund at the relevant accounting date. The financial year for all the schemes shall end as on March 31st of that financial year.

Fees and Expenses

- Investment and advisory fees charged by the asset management company are to be fully disclosed in the offer document. The asset management company can charge one and a quarter of one per cent of the weekly average net assets outstanding in each accounting year for the scheme concerned, as long as net assets do not exceed Rs. 100 crores. The asset management company can also charge one per cent of the excess amount over Rs. 100 crores where net assets exceed Rs. 100 crores. In case of an index fund scheme, the investment and advisory fee shall not exceed three fourth of one per cent (0.75%) of the weekly average net assets.

- In addition to the above, the asset management company can charge recurring expenses including marketing and selling expenses including agents’ commission, brokerage and transaction cost, fees and expenses of trustees, custodian fees, audit fees, costs of fund transfer from location to location; costs related to investor communication; costs of providing account statements and dividend/redemption cheque and warrants; winding up costs for terminating a fund or a scheme; cost of statutory advertisements; in case of a gold exchange traded fund scheme, recurring expenses incurred towards storage and handling of gold; in case of a capital oriented scheme, rating fees; listing fees, in case of scheme listed on a recognized stock exchange and such other costs as may be approved by the Board.

- The total expenses of the scheme, excluding issue or redemption expenses, whether initially borne by the mutual fund or by asset management company, but including the investment management and advisory fee, shall be subject to following limits:
  (a) In case of a fund of funds scheme, the total expense of the scheme including the management fees shall be either:- (i) not exceeding 0.75% of the daily or weekly average net assets, depending upon whether the
NAV of the scheme is calculated on daily or weekly basis; or (ii) it may consist of (A) management fees for the scheme not exceeding 0.75% of the daily or weekly average net assets, depending upon whether the NAV of the scheme is calculated on daily or weekly basis; (B) other expense relating to administration of the scheme; (C) charges levied by the underlying schemes. Provided that the sum total of (A), (B) and the weighted average of the total expense ratio of the underlying schemes shall not exceed 2.5% of the daily or weekly average net assets, depending upon whether the NAV of the scheme is calculated on daily or weekly basis of the scheme.

(b) in case of an index fund scheme or exchange traded fund, the total expenses of the scheme including the investment and advisory fees shall not exceed one and one half per cent (1.5%) of the weekly average net assets;

(c) in case of any other scheme:

- On the first Rs. 100 crores of the daily or average weekly net assets- 2.5 per cent;
- On the next Rs. 300 crores of the daily or average weekly net assets- 2.25 per cent;
- On the next Rs. 300 crores of the daily or average weekly net assets- 2 per cent and
- On the balance of the assets 1.75 per cent

In the case of scheme investing in bonds, such recurring expenses will be reduced by at least .25 per cent of the daily or weekly average net assets outstanding in each financial year.

- Every mutual fund and asset management company shall send dividend warrants to the unit holders within 30 days of the declaration of the dividend, and the repurchase and redemption proceeds shall be sent within 10 working days of the date of repurchase or redemption. In the event of failure to dispatch the redemption or repurchase proceeds within the period, the asset management company shall be liable to pay interest to the unit holders at such
rate as may be specified by the Board for the period of such delay; notwithstanding payment of such interest to the unit holders the asset management company may be liable for penalty for failure to dispatch the redemption or repurchase proceeds within the stipulated time.

- Every mutual fund or asset management company shall prepare an annual report and statement of accounts of the scheme. Every mutual fund will have to audit their annual statement of accounts by auditor. Auditor shall be appointed by the trustees. Auditor shall forward his report to the trustees and such report shall form part of annual report of the mutual fund. The scheme-wise annual report or an abridged summary providing true and fair view of the operation of the mutual fund shall be mailed to all unit holders within four month from the date of closure of the relevant accounting year. The report shall be available for inspection at the Head Office of the mutual fund and a copy shall be made available to unit holder on payment of nominal fee as may be specified by the mutual fund.

- The trustees, asset management company, custodian, sponsor shall be bound to make such disclosures as may be called upon to do so by the Board.

- Mutual fund shall furnish the following periodic reports to the Board (a) Copies of duly audited annual statement of accounts (b) a copy of six monthly un-audited accounts (c) a quarterly statement of movement in the net assets for each of the scheme of the fund (d) a quarterly portfolio statement including changes from the previous period for each scheme.

- A mutual fund and asset management company shall before the expiry of one month from the close of each half year that is on 31st March and 30th September publish its un-audited financial results in one English daily newspaper circulating in the whole of India and regional newspaper where the Head Office of the mutual fund is situated.

- The trustees shall be bound to make such disclosures to the unit holders as are essential in order to keep them informed about any information which may have an adverse bearing on their investments.
4.2.7 Inspection and Audit

The regulations also incorporate inspection and audit procedures. SEBI can appoint one or more persons as inspecting officer to undertake the inspection of books of accounts, records, documents and infrastructure, system and procedures or to investigate the affairs of the mutual funds, the trustees and asset management company. SEBI can inspect the books of accounts to ensure that they are maintained as per guidelines, to ascertain whether provisions of the Act and these regulations are complied with and the system and procedures are adequate. SEBI can investigate into complaints of investors or any other persons on any matter having a bearing on the activities of the mutual funds, trustees and asset management company. SEBI will ensure that the affairs of the mutual fund, trustees or asset management company are being conducted in a manner which is in the interest of the investors or the securities market. The Board will give not less than ten days notice to the mutual fund, asset management company or trustees before ordering an inspection or investigation. However, where the Board is satisfied that in the interest of the investors no such notice should be given, it may direct that such inspection be taken up without such notice. The inspecting officer, in the course of inspection or investigation, shall be entitled to examine or record the statements of any director, officer or employee of the mutual fund, trustees and asset management company. It shall be the duty of every director, officer or employee of the mutual fund, asset management company or trustee to give to the inspecting officer all assistance in connection with the investigation. The inspecting officer shall, as soon as possible, on completion of the inspection or investigation submit a report to the Board. The Board or the Chairman shall after consideration of inspection or investigation report take such action as the Board or Chairman may deem fit and appropriate including action under the Securities and Exchange Board (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002. The Board shall have the power to appoint an auditor to inspect into the books of account or affairs of the mutual fund, trustees or asset management company. The Board shall be entitled to recover such expenses including fees paid to the auditors as may be incurred by it for the purposes of inspecting the books of account, records and documents of the mutual fund, the trustees and asset management company.
4.2.8 Procedure for Action in Case of Default

The Board may initiate action for suspension or cancellation of registration of an intermediary holding a certificate of registration under section 12 of the Act who fails to exercise due diligence or to comply with the obligation in case a mutual fund which contravenes any provision of the regulations, fails to furnish information and submit periodic returns or comply with the directions of the board, fails to resolve the complaints of the investors or fails to give a satisfactory reply to the Board on this behalf; fails to maintain the net worth by asset management company in accordance with the provision of regulation 21; fails to pay any fees; violates the condition of registration; is guilty of misconduct or does not cooperate with any inquiry or inspection. The Board may in addition to suspension or cancellation of certificate, order suspension of launching of any scheme of a mutual fund for a period not exceeding one year for violation of any of these regulations.

4.3 CONCLUSION

The impact of the regulations was immediately felt. Asset Management Companies framed several schemes which made use of the freedom provided to them by the new regulations. Not only did the number of schemes filed with SEBI increased significantly in a short period of time but also there was a greater variety in the investment products offered. There was also a significant improvement in disclosures in the offer documents.

The regulations have brought into greater focus the responsibilities of trustees of mutual funds who are uniquely positioned to promote the interest of the unit holders and to ensure that mutual funds are managed responsibly and ethically. The trustees act independently to uphold the public trust.

SEBI is using its interface with AMFI to assess the impact of the new regulations on the working of mutual funds and to examine further ways of improving the performance of mutual funds so as to restore investors’ confidence in them. SEBI also continued working with AMFI so that it becomes a more effective body representing the mutual fund industry and embarks on a campaign to sharpen the industry’s focus on the consumer